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**THE FOOD-FUEL-FINANCIAL CRISIS AND CLIMATE CHANGE:  
ADDRESSING THREATS TO DEVELOPMENT**

*Note by the secretariat*

**SUMMARY**

The sudden convergence of the food, fuel and finance crises against the backdrop of climate change has exacerbated the day-to-day difficulties faced by many, especially the millions of poor who have been the hardest hit. While food and fuel prices have come down from their high levels of 2008, the countries of the Asia-Pacific region are grappling with an unprecedented economic slowdown in the world's developed countries. This slowdown is pulling down growth rates of economies in the region, reducing income, employment, livelihood opportunities and Government revenue in all countries. As a result, new investments may be postponed, poverty could increase and millions could fail to consume the basic minimum. The pace of development, especially in regard to achieving the Millennium Development Goals, will not only slow down, but the gains made could be reversed, raising questions as to the feasibility of achieving many of the Goals by 2015, unless immediate mitigation actions are taken.

In the present document, the secretariat: (a) highlights some of the issues associated with the food-fuel-financial crisis that are relevant for least developed countries, landlocked developing countries and small island developing States (together referred to as countries with special needs); (b) describes a few attributes of the financial crisis and their social impacts, including responses from Governments and international organizations; and (c) provides recommendations for dealing with the crises through regional cooperation initiatives.

The present document summarizes various countercyclical measures being taken by countries with special needs to respond to the crises and highlights constraints, including the narrow fiscal and foreign exchange policy space such countries have in which to expand responses and adequately mitigate the adverse impacts. The document further discusses the recommendations of the High-level Regional Policy Dialogue on The Food-Fuel Crisis and Climate Change: Reshaping the Development Agenda, held by ESCAP and the Government of Indonesia on 9 and 10 December 2008 in Bali, Indonesia, to assist countries in their efforts to cope with and even prevent crises. The Bali Outcome Document contains proposals for regional cooperation initiatives, including strengthening existing mechanisms, establishing

\* The late submission of the present document is due to delays in the clearance procedures of the secretariat.

new mechanisms to support countries in balance of payments difficulties, and providing a channel through which countries affected by the crisis could receive budget financing, especially for activities related to the Millennium Development Goals.

The Commission may wish to review the recommendations of the Bali Outcome Document, as summarized in the present document, and provide guidance on their implementation.

## CONTENTS

	<i>Page</i>
Introduction.....	3
I. THE FOOD-FUEL CRISIS .....	3
II. THE FOOD-FUEL CRISIS, CLIMATE CHANGE AND SMALL ISLAND DEVELOPING STATES: TWO CASE STUDIES .....	7
A. National policies to address the food-fuel crisis .....	7
B. Climate change .....	7
III. THE FOOD-FUEL-FINANCIAL CRISIS AND COUNTRIES WITH SPECIAL NEEDS: MACROECONOMIC IMPACTS .....	8
The macroeconomic impact of the crises on least developed economies in the region .....	8
IV. THE FINANCIAL CRISIS AND GLOBALIZATION .....	9
A. The financial crisis and its links with the food and fuel crises .....	11
B. Commodity and credit booms .....	11
C. Speculation and commodity prices .....	12
V. RESPONSES OF COUNTRIES WITH SPECIAL NEEDS TO THE FINANCIAL CRISIS .....	12
VI. INTERNATIONAL RESPONSES TO THE TRIPLE CRISIS .....	16
A. The High-level Task Force on the Global Food Security Crisis and its Comprehensive Framework of Action .....	16
B. Consolidated United Nations responses to the global financial crisis and CSNs: guiding principles .....	17
VII. THE WAY FORWARD: A REGIONAL RESPONSE .....	18
A. Crisis convergence .....	18
B. The role of regional cooperation .....	18
C. Conclusions .....	19
Figure. Food price index and Brent crude oil price, 1980-2008 .....	13

## List of tables

1. Responses of selected countries with special needs to the food crisis .....	5
2. Selected least developed economies in the ESCAP region: some macroeconomic indicators .....	10
3. Country responses to the financial crisis .....	14

## **Introduction**

1. Crises are signs that the development process is not smooth and that development gains are under threat and could be reversed. Last year the countries of the Asia-Pacific region, as elsewhere, experienced a dual food-fuel crisis. The prices of both these essential items increased exponentially, which had the potential to inflict serious social and economic consequences in developing countries. Although food-fuel prices have abated from their record levels, many countries of the region are grappling with the repercussions of the global financial crisis, which has become an economic crisis. The spillover effects of the financial-economic crisis in the developed countries are being felt across the board, including in countries that were not responsible for generating the crisis, with consequent negative impacts on economic growth, employment and income.

2. The relatively sudden convergence of these crises against the backdrop of adverse impacts of climate change has posed serious challenges to the policymakers of the region. In this connection, the major objectives of the present document are to: (a) highlight issues associated with the convergence of the food, fuel and financial crises that are relevant for least developed countries, landlocked developing countries and small island developing States (together referred to as countries with special needs (CSNs)); and (b) analyse the overall macroeconomic impacts of the crises.

3. The present document also describes some special attributes of the financial crisis and its social impacts, and points out linkages between the financial, food and fuel crises. It deals with responses undertaken by Government and international organizations, and provides recommendations for dealing with the adverse impacts of the food-fuel-financial crisis through regional initiatives.

4. As the food-fuel crisis, which has somewhat abated recently, has been much written about and analysed, it will not be dealt with in detail in the present document. First, a background and situation analysis of the dual food-fuel crisis will be discussed. Second, case studies of two small island developing States (SIDS) which have been strongly affected by the food-fuel crisis and climate change will be used to illustrate the relevant issues.

## **I. THE FOOD-FUEL CRISIS**

5. As indicated above, the countries of the Asia-Pacific region, as in the rest of the world, experienced unprecedented increases in food and fuel prices, signifying that demand had outstripped supply by wide margins. As a result, a dual crisis loomed large and there was a danger that people in developing countries of the region, especially least developed countries (LDCs) would not be able to consume the quantities of food and energy required for maintaining subsistence levels of human and economic activities. Due to the food-fuel crisis, economic growth could slow down; many Millennium Development Goal achievements could be reversed, leading to a disproportionate increase in the burden on the poor, women and other vulnerable groups. In short, countries could face setbacks in terms of the progress they have made towards strengthening inclusive development.

6. The reasons for the crises are many. Some are short term, others emanate from medium- to long-term structural trends. Some are under the control of national Governments; some are not, and merit collective actions. A range of factors among the short-term issues, such as weather-induced production shortages, the diversion of a part of food crops to the production of ethanol, and the resulting spurt in speculative activities or food hoarding. In many countries, the relative neglect of agriculture, including food crops, in the form of reduced public and private investment in research

and development activities, irrigation and rural infrastructure, gave rise to supply rigidities which contributed to the current crisis.<sup>1</sup>

7. The relative neglect of issues pertaining to food production, distribution and access has given rise to persistent food insecurity in the Asia-Pacific region, an issue dealt with in detail in the theme study *Towards Sustainable Agriculture and Food Security in the Asia-Pacific Region*, which is summarized in E/ESCAP/65/29. The study describes a number of long-term issues which were responsible for the recent food crisis and its eventual abatement. The main issues relevant to the present context are the following:

(a) How can countries in the Asia-Pacific region reconcile the competing needs associated with the security of food, water and energy while reversing environmental degradation and fighting climate change?

(b) What measures are being implemented to ensure that food security in Asia and the Pacific is enhanced through international trade, given the context of globalization?

(c) How can countries in the Asia-Pacific region manage shocks and risks?

(d) How and when can Governments institutionalize a social protection system that will ensure food security for special groups, or “arrangements of special access to food on the part of vulnerable people (including deprived mothers and small children)”?”<sup>2</sup>

8. The steep price increases in the international market were beyond the control of most Asia-Pacific countries that are net importers of petroleum, and came as exogenous shocks. Energy prices increased steeply with strong knock-on effects on the production costs/prices of all sectors of the economy, including agriculture, which exacerbated the food crisis. Such countries have been forced to cope with steep increases in energy prices, which has negatively affected macroeconomic indicators, especially inflation, fiscal deficit and balance of payments.

9. There are two-way relationships between the food-fuel-financial crisis and climate change. The current financial crisis could threaten actions on climate change by not only curtailing the availability of financial resources for mitigation and adaptation measures, but also by diverting the attention of policymakers from long-term issues. It is urgent, therefore, to coordinate action on these fronts to ensure a win-win situation where investments to address economic slowdown also address sustainable development issues. Likewise, the food and fuel crises have strong linkages with climate change. For example, while high oil prices triggered a price bubble, they also sparked investment in technology and renewable energy, and a shift to the production of biofuel could affect climate change if forest land is utilized for biofuel crops. At the same time, climate change will have a serious adverse effect on agricultural productivity. According to estimates from the Intergovernmental Panel on Climate Change, agricultural productivity in the Asia-Pacific region could drop by 5 to 30 per cent. Without a substantial increase in agricultural productivity, the impact of climate change on food security and price escalation will be significant. Greater

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<sup>1</sup> ESCAP, *Economic and Social Survey of Asia and the Pacific 2008* (United Nations publication, Sales No. E.08.II.F.7).

<sup>2</sup> Amartya Sen, *Hunger in the Contemporary World*, Discussion Paper DEDPS/8, (London, The Suntory Centre, Suntory and Toyota International Centers for Economics and Related Disciplines, London School of Economics and Political Science, 2002).

investment in research and development will be needed to create high yielding varieties of seeds that are drought and heat resistant.<sup>3</sup>

10. National Governments have been trying hard to address the dual crisis by adopting various macroeconomic (viz. fiscal and monetary) measures as well as targeted programmes to directly benefit the poor and low-income populations. However, many countries, especially LDCs, have very limited fiscal and monetary space in which to handle the crisis on their own. It is the collective responsibility of all developing countries in the region and regional development stakeholders to suggest and implement a regional partnership mechanism to increase the effectiveness of national policies.

11. As the fuel crisis was totally exogenous to CSNs, the countries were limited to reactive responses. This section of the present paper focuses on an analysis of country responses to the fuel crisis, which include a mixture of short-, medium- and long-term policies. Table 1 summarizes the efforts national Governments have made in dealing with the dual crisis. Policies of selected CSNs are analysed to indicate the main instruments through which the adverse impacts have been mitigated.

**Table 1. Responses of selected countries with special needs to the food crisis**

<i>Country</i>	<i>Response</i>
Mongolia	<p>Real gross domestic product is projected to grow about 9 to 10 per cent in 2008 on the back of strong performance in agriculture and services. Inflation, which was 6 per cent in June 2007, peaked at 34 per cent in August, before declining to 32 per cent in September, consistent with the drop in food prices. On the demand side, large increases in civil service wages and rapid expansion of credit contributed to inflation; on the supply side, soaring food and oil import prices played a crucial role.</p> <p>In an effort to stabilize food and fuel prices, the authorities introduced: (a) temporary exemptions on value added tax and customs duties on wheat and flour imports; (b) measures to build up wheat, flour and meat reserves; and (c) temporary subsidies to reduce the interest expenses of petroleum importing companies.</p>
Nepal	<p>Increasing food prices considerably slowed the recent progress towards the Millennium Development Goals by reducing household and national food availability and thus threatening development. Food prices have come down from their peak in mid-2008, but are expected to remain firm over the medium run.<sup>a</sup></p> <p>With assistance from the World Bank, the Government of Nepal is implementing a project to address the short-, medium- and long-term impacts of rising food prices. The proposed Nepal Food Price Crisis Response Program is aimed at supporting measures to maintain and enhance food security, such as ensuring that vulnerable households in food insecure districts have access to basic requirements (mainly food) and boosting agricultural yield to increase the domestic production of staples.</p>

<sup>3</sup> For more on these and other aspects of climate change, see E/ESCAP/65/29.

Cambodia	<p>The increased cost of inputs (especially fertilizers and energy/transport) due to increased petroleum prices has been a burden on farmers. On the other hand, the poor and most farmers also pay the higher food price. Government response to the crisis has come at three levels:<sup>b</sup></p> <p>(a) <i>Short-term</i>. Several measures have been taken, including interministerial discussions, a salary increase for civil servants, the granting of soft loans to rice millers and a temporary ban on paddy export (March-May 2008);</p> <p>(b) <i>Medium-term</i>. Measures included inflation control through monetary and fiscal measures, reduction of import taxes on food, increasing agricultural productivity and augmenting yield, increasing irrigated land and land available for cultivation, and forming a price monitoring working group;</p> <p>(c) <i>Long-term</i>. Priority areas have included grain storage facilities at the provincial and national levels, increasing cropping intensity, strategies for reducing post-harvest losses and the potential for agriculture development.</p>
Tajikistan	<p>In a survey conducted by a national-level forum on emergency preparedness and response it was reported that many residents, both in the capital and other areas, experienced difficulties purchasing food as a result of high food prices, food shortages and limited access to markets due to adverse weather conditions. Rural households surveyed by food cluster members revealed that food supplies were severely constrained and that people were facing extreme hardships. Distributions of a variety of critical food and non-food items were identified as measures which could counterbalance the immediate impact of the crisis. Two other measures were also identified, namely, increasing economic means to acquire food and combating locust infestations through pesticide and equipment. The Government has proposed implementing the activities with the assistance of the United Nations Country Team.<sup>c</sup></p>

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Notes: <sup>a</sup> World Bank, "Report No. AB4164" on the Nepal Food Crisis Response Program, Project Information Document, accessed from <http://reliefweb.int/rw/rwb.nsf/db900sid/FBUO-7JLC5U?OpenDocument> on 18 February 2009.

<sup>b</sup> United Nations in Cambodia, "Rising Food Prices", discussion paper (available at [www.un.org.kh/index.php?option=com\\_content&view=article&id=103:rising-food-prices-discussion-paper-&catid=46:rising-food-prices](http://www.un.org.kh/index.php?option=com_content&view=article&id=103:rising-food-prices-discussion-paper-&catid=46:rising-food-prices)).

<sup>c</sup> Office for the Coordination of Humanitarian Affairs, *Tajikistan: Compound Crises Flash Appeal Revision 2008*, accessed from [www.reliefweb.int/rw/rwb.nsf/db900sid/LSGZ-7EGFC2?OpenDocument](http://www.reliefweb.int/rw/rwb.nsf/db900sid/LSGZ-7EGFC2?OpenDocument) on 18 February 2009.

12. Table 1 shows that, in order to address rising food prices and the hardships they inflict, and enable people to meet their basic needs, social safety-net programmes have had to be implemented, often with assistance from international organizations. Tax exemptions and subsidies have been used to lower food prices. At the same time, most of the countries embarked on activities to boost agricultural yield to increase the domestic production of staples, at least in the medium run. To ensure

the availability of staples, imports have been kept up, which in many circumstances added to the strain on the balance of payments accounts. Several grain-producing countries put a ban on grain exports to ensure availability in the local market.

## **II. THE FOOD-FUEL CRISIS, CLIMATE CHANGE AND SMALL ISLAND DEVELOPING STATES: TWO CASE STUDIES**

13. Increases in food-fuel prices have the capacity to strongly affect the economies of Kiribati and the Solomon Islands. The inflation rates on the islands have been affected, which has reduced economic growth. These countries import all their fuel and some food commodities, thus global food-fuel price increases can easily put stress on their limited fiscal and foreign exchange resources. For example, the cost of subsidizing rice in Kiribati was \$2 million for the period July-December 2008, which is substantial considering the limited resource base of the country.<sup>4</sup>

### **A. National policies to address the food-fuel crisis**

14. In Kiribati, the Government has established Food and Fuel Crisis Task Forces to implement both short- and long-term mitigating measures. The task forces are empowered to review the current import arrangements and other factors that contribute to the price of imported commodities, such as freight charges and import levies, and engage with local companies to promote bulk purchasing. The task force dealing with the social aspects of the food crisis has recommended ways in which local products/food could be used, and encouraged people to depend less on imported food and begin growing their own. The fuel task force is responsible for reviewing subsidies and recommending to the Government the levels that will ensure that the price of fuel (especially kerosene, used by most of the lower-income population) remains affordable.

15. In the Solomon Islands, Government agriculture policy has increased emphasis on food security. A two-pronged strategy has been followed. First, actions were taken to ensure that sustainable production of traditional staple food crops would keep pace with the growing population. Second, local production was promoted through new projects that were aimed at growing crops that traditionally have been imported (rice, for example). The Government has strongly supported this strategy; it approved a \$2 million rice project as a means of reducing vulnerability to the price of imported rice. The latest attempt to promote food security is the development of a National Agriculture Development Plan. The 25-year Plan will become a road map for Governments.<sup>5</sup>

### **B. Climate change**

16. Climate change in Kiribati has a substantial impact on food security. Changes in regional weather patterns have impacted on the rainfall replenishment of aquifers, affecting the yield of food crops and the availability of drinking water. Increased occurrence of storms and cyclones has led to increased erosion and salt water intrusion, which have affected food crops. Storm surges have flooded land area. A vulnerability and adaptation assessment of key locations on the main island of Tarawa predicted that, if no changes are made, in 50 years annual damages could be

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<sup>4</sup> Terieta Mwemwenikeaki, "Food-Fuel Crisis and Climate Change: Perspectives from Small Island States", presentation at the High-level Regional Policy Dialogue on the Food-Fuel Crisis and Climate Change: Reshaping the Development Agenda, Bali, Indonesia, 9-10 December 2008.

<sup>5</sup> Alfred Maesulia, "Food-Fuel Crisis and Climate Change: Perspectives from Small Island States", presentation at the High-Level Regional Policy Dialogue on The Food-Fuel Crisis and Climate Change: Reshaping the Development Agenda, Bali, Indonesia, 9-10 December 2008.

in the range of \$8 million to \$16 million. It has been estimated that by 2050, 55 per cent of the island's land area will be inundated by storm surge as a result of climate change; this proportion could rise to 80 per cent by 2100. Although Kiribati has developed mitigation and adaptation policies and strategies to address the impacts of climate change, the international community should provide the country with the technical and financial assistance required to cope with such impacts.<sup>6</sup>

17. In the Solomon Islands, the impacts of climate change that have a strong bearing on food security include: (a) increased intensity/frequency of cyclones; (b) multiplication of pests and diseases that destroy crops and populations; (c) storm surges that cause floods, especially in low-lying areas, salt water intrusion, sea level rise and costal erosion; and (d) higher temperatures, resulting in decreased yield of taro on coastal lowlands and drought in localized areas of the country.

### **III. THE FOOD-FUEL-FINANCIAL CRISIS AND COUNTRIES WITH SPECIAL NEEDS: MACROECONOMIC IMPACTS**

18. In 2007 and early 2008, the Asia-Pacific region was faced with the dual challenge of food and fuel crises which were unfolding against the backdrop of a significantly heightened global concern for climate change.

19. Food insecurity has been a major development challenge for CSNs, greatly complicating their fight against income and non-income poverty, in particular, and efforts to achieve the Millennium Development Goals in general. Such countries are also highly vulnerable to fuel price volatility and climate change, bearing the major brunt of the adverse impacts of these threats. High food and energy prices have put tremendous pressure on the fiscal and foreign exchange resources of CSNs, as they have had to maintain imports of essential items to ensure domestic availability while providing subsidies to facilitate consumption. Climate change, particularly sea-level rise, could impose incalculable economic, social and environmental costs on the coastal areas of many island countries, reducing their ability to survive as viable States.

20. To these challenges have been added the downstream impacts of the recent global financial-cum-economic crisis. Although they have only weak direct links with global financial systems, several CSNs have already reported slowdowns in their current and projected growth rates, with falling exports and rising unemployment threatening their economic and social stability. The situation of least developed countries is further illustrated below.

#### **The macroeconomic impact of the crises on least developed economies in the region**

21. It was expected that, due to structural constraints which make the least developed countries more vulnerable to the crisis than others, the magnitudes of the adverse macroeconomic impacts would be substantial. Such impacts are shown in Table 2, manifested in the gross domestic product (GDP) growth rates (2006-2009), inflation rates (2006-2009), budget balance (2006-2008), and current account balance (2006-2008) of the major LDCs in the region.

22. There was an across-the-board slowdown in economic growth from 2007 to 2008, and estimates indicate that it continued from 2008 to 2009. In fact, the slowdown in 2009 is expected to be significant for a number of countries. The surge

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<sup>6</sup> Ibid.



in inflation in 2008, due to the steep increases in food and fuel prices, is evident in all cases. This phenomenon is also reflected in the table, which shows that budget deficits increased as the need to subsidize consumers became stronger. Budget balance as a percentage of GDP increased for many LDCs, which reduced their fiscal space. The higher prices of both food and petroleum—major import items for LDCs—have put pressure on import payments, and current account balances in 2008 worsened in all LDCs.

23. In short, the overall macroeconomic picture in 2008 was characterized by stagflation, reduced growth, higher inflation and worsening budget and current account deficits. In 2009, economic growth is expected to slow further. However, inflation is projected to decrease substantially.

#### **IV. THE FINANCIAL CRISIS AND GLOBALIZATION**

24. The current financial crisis has evolved differently from other major crises that have hit the developing world in recent decades. It is taking place in a world of financial globalization, in which the financial sector has played a strong role in shaping many economic activities. It is an “imported” crisis, with origins outside the developing world. The crisis also came almost in tandem with major global shocks from high food and fuel prices that imposed a heavy economic burden on many countries and that had significant impacts on poverty and vulnerability.

25. Many Asia-Pacific developing countries, especially CSNs, are experiencing new levels of vulnerability, as exports, investment, credit, banking systems, budgets and balance of payments show increasing volatility and affect economic growth. As discussed previously, the financial crisis has been slowing down growth in developing countries. However, the slowdown has been much more prominent in developed countries—some are already in recession. As a result, developing country exports to developed countries have been falling, capital is being withdrawn from emerging markets and short-term credit is drying up. This could trigger a fall in production and investment in the productive sectors of developing countries. Sharply tighter credit conditions and weaker growth are likely to cut into Government revenues and Government ability to invest to meet education, health and other social goals. Coming just after the food and fuel price shock, the global financial crisis could significantly set back the fight against poverty.

26. Recent declines in food and fuel prices do not imply that pressures and problems have disappeared. For the very poor, reducing consumption from already very low levels, even for a short period, has long-term consequences. The poorest households might have had to reduce the quantity and/or quality of their food, schooling, and other basic services, leading to irreparable damage to the health and education of millions of children. Poor households which have switched from more expensive to cheaper and less nutritional foodstuffs, or have cut back on total intake, could face weight loss and malnutrition. The recent high food prices might have already increased the number of children suffering permanent cognitive and physical injury due to malnutrition by 44 million. Regardless of recent declines in global food and fuel prices, this represents a tragic loss of human and economic potential.<sup>7</sup>

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<sup>7</sup> World Bank, “Global Financial Crisis and Implications for Developing Countries”, G-20 Finance Minister’s Meeting, São Paulo, Brazil, 8 November, 2008, accessed from [www.worldbank.org/html/extdr/financialcrisis/pdf/G20FinBackgrounder.pdf](http://www.worldbank.org/html/extdr/financialcrisis/pdf/G20FinBackgrounder.pdf) on 12 February 2009.

**Table 2. Selected least developed economies in the ESCAP region: some macroeconomic indicators**

<i>Country</i>	<i>GDP growth (percentage)</i>			<i>Inflation (percentage)</i>			<i>Budget balance (percentage of GDP)</i>			<i>Current account balance (percentage of GDP)</i>		
	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>
Afghanistan	11.5	7.5	..	13.0	24.0	..	..	..	..	-4.9	0.9	0.6
Bangladesh	6.5	6.2	5.5	7.2	9.9	8.5	-3.9	-3.7	-4.8	1.3	1.4	0.9
Bhutan	17.6	14.4	..	5.2	9.0	..	-0.8	0.5	..	-4.3	11.3	..
Cambodia	10.2	7.0	6.8	5.9	15.0	4.5	-3.3	-2.8	-2.2	-2.0	-3.0	-7.7
Kiribati	0.5	0.6	0.8	0.2	1.0	1.5	26.0	..	..	-27.6	-31.1	-43.7
Lao People's Democratic Republic	7.9	7.5	6.8	4.5	8.0	5.3	-4.0	-3.1	-3.0	1.4	2.6	..
Maldives	7.6	7.0	..	7.4	15.0	..	-7.1	-7.8	-9.4	-40.5	-45.0	-51.0
Nepal	2.6	5.6	5.5	6.4	7.7	7.0	-3.8	-4.1	-4.0	2.2	-0.1	2.6
Samoa	4.7	3.3	3.0	5.6	6.5	5.2	0.3	1.1	-0.3	-10.8	-4.6	-7.8
Solomon Islands	10.3	8.0	4.0	7.7	15.1	9.0	-4.0	-1.1	1.3	-5.5	-2.7	-6.7
Timor-Leste	16.2	4.7	..	8.9	9.0	..	242.0	297.0	352.0	162.4	294.9	357.1
Tuvalu	2.0	1.2	1.6	3.3	5.3	3.9	18.7	-14.3	..	..	..	..
Vanuatu	6.6	5.7	2.9	3.9	4.5	3.6	1.2	-0.3	1.0	-5.7	-9.9	-11.4

*Sources:* ESCAP, *Economic and Social Survey of Asia and the Pacific 2009*, Statistical Annex (United Nations publication, Sales No. E.09.II.F.11, forthcoming); national sources; and ESCAP estimates as of 3 December 2008.

27. The food and fuel price shocks have already imposed large fiscal costs on developing countries, undermining their ability to respond to fallout from the financial crisis through countercyclical expenditure policies. Policymakers, responding to high food and fuel prices, made extensive use of tax reductions or increased subsidies to offset higher prices, and took to income support in some cases. The reliance on across-the-board tax reductions and subsidies could pose future difficulties such as a loss of fiscal space, because these measures have been costly and difficult to reform once in place. Fuel subsidies, if not targeted properly, could have environmental consequences. Instead of ad-hoc “fire-fighting” arrangements, subsidies on essential items, such as food and fuel, could be made a part of the fiscal space in order to accommodate a permanent increase in the size of targeted safety nets. Careful fiscal planning is needed to protect critical growth-enhancing spending, prune low-priority expenditures and ensure fiscal sustainability in the medium term. These needs will only increase as the global financial crisis takes its toll.

#### **A. The financial crisis and its links with the food and fuel crises**

28. The financial crisis seems to be at least somewhat linked to the pace of global expansion. The current crisis came after five years of exceptional global performance. Forces which drive economic expansion can also lead to crises; economic activity increasingly governed by financial boom-bust cycles in both developed and developing countries of the Asia-Pacific is no exception, as evidenced by the 1997 financial crisis. One factor has been rapid credit expansion, sometimes without adequate attention to the risk factors. In certain ways, this phenomenon helped to expand the economy by reducing the cost of financing. However, the risk factors of such a measure can increase vulnerability to crises, as evidenced by the subprime crisis in the United States of America.

29. Similar to the credit expansion, a surge in external capital flows from developed to developing countries has been responsible for supporting economic expansion in the latter. The expansion came through two channels that increase economic growth: first, an increased wealth effect and second, the confidence of domestic and international investors in the fundamentals of the developing economies. The search for higher yield in developed countries, triggered by ample liquidity and low interest rates, played a central role in the increase of capital flows to emerging markets. Such strong capital inflows often created pressures on exchange rates and led to excess liquidity in the receiving developing countries. In some cases, credit and asset bubbles were formed. Nevertheless, the capital inflows into many developing Asia-Pacific countries have contributed to reductions in the costs of financing, which is usually considered conducive to economic growth.

#### **B. Commodity and credit booms**

30. As discussed above, it is the commodity price boom which culminated in the food and fuel crises. The commodity boom started in 2003 and accelerated after December 2006. For food, acceleration came in the second half of 2006. Both fuel and food prices reached their breaks in July 2008, followed by declines. However, the price booms, especially in oil, contributed to the credit expansion in two ways. First, in the readiness of the countries which benefitted from the oil price increase to provide the United States with cheap credit, which helped sustain its property market and higher consumption levels. Second, oil surpluses have been recycled not only to the United States, but also, as in the 1970s, to developing countries running large, growing current account deficits. Unlike the 1970s, however, this took place largely in the form of portfolio flows and foreign direct investment rather than syndicated bank lending.

31. The current commodity price boom, including both oil and food, has been driven primarily by the expansion of demand—both real and speculative. In terms of oil, there is a contrast to the 1970s, when price rises were triggered by supply shocks. The impacts of supply and demand fundamentals on growth are often difficult to disentangle and do not always exhibit a clear cause-effect link. However, there has been consensus on the role of strong demand from developing countries with commodity-intense growth patterns. Furthermore, low initial stock, a weak supply response and a weak dollar encouraged imports. For food-secure populations, additional factors had impacts on the boom-bust cycle. Boom periods supported a diversion to biofuels—sometimes supported by subsidies. Poor harvests in many countries, the changing demand patterns of the middle class in several emerging developing countries, and a passing through of higher costs for fuel, fertilizers, transport and storage also led to shortages.

### **C. Speculation and commodity prices**

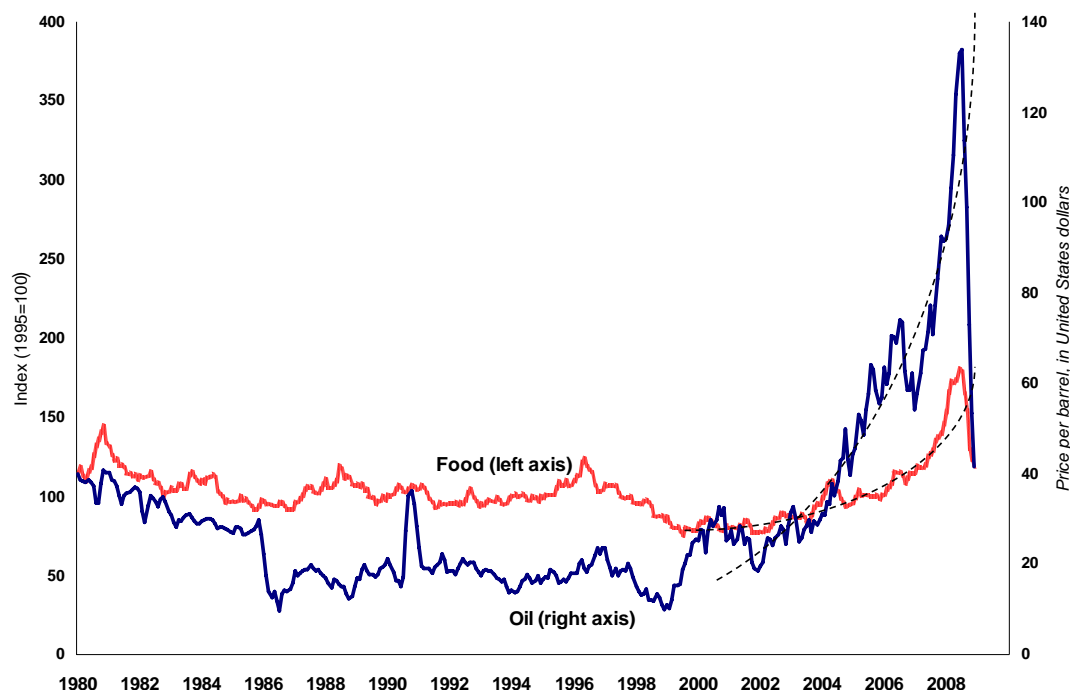
32. Investing in indexed assets (for example, commodities or stocks), or index trading, has increased rapidly after 2003. For example, after only five years of issuance, the investment volume in an index fund representing a bundle of 24 agricultural and non-agricultural commodities reached \$317 billion in July 2008. Such trading was often driven by speculators who sought short-term profits from increased volatility, and contributed to the spike in prices.

33. Speculation appears to be an important factor not only in the acceleration of fuel and food prices but also in their subsequent decline. When growth prospects looked good and demand was expected to surge from 2007 to mid-2008, price spikes in both food and fuel appeared. When the financial crisis brought down the growth expectation to the level of an expected recession in many countries, prices dropped. Without speculative demand playing a substantial role in generating a supply-demand imbalance, which was eventually “market cleared”, such price behaviours are difficult to explain. The behaviour of food and fuel prices during 1980 to 2008 is shown in the figure. In fact, the exit from commodity futures coincided with mounting problems with major United States banks, their contagion effects and downward revisions of growth rates by international bodies such as the International Monetary Fund led to a sharp fall in commodity prices.

## **V. RESPONSES OF COUNTRIES WITH SPECIAL NEEDS TO THE FINANCIAL CRISIS**

34. Although many developing Asia-Pacific countries, especially CSNs, are not as financially integrated as developed countries, which have witnessed the worst financial crisis in recent times, they cannot avoid the ripple effects of the global economic crisis. The crisis, triggered by a substantial slowdown in the economies of developed countries, impacted CSNs mainly in terms of demand. Exports of CSNs slowed, which brought down GDP growth rates in 2008-2009 (see E/ESCAP/65/30). As a result, employment and income generation slowed, worsening the living conditions of many people, especially the poor, and threatening to reverse the development gains achieved so far.

**Figure. Food price index and Brent crude oil price, 1980-2008**



Source: ESCAP, based on data from the International Monetary Fund (available at [www.imf.org/external/nap/res/commo/externaldata.csv](http://www.imf.org/external/nap/res/commo/externaldata.csv)).

35. Governments have designed various countercyclical compensatory measures to keep up GDP growth rates in the wake of the global recession. Such measures have been expansionary and were expected to compensate for the loss of export demand. Major activities supported through such measures include: (a) expansion of public infrastructure; (b) employment creation and other social sector programmes; and (c) subsidies and tax cuts to boost consumption, especially of food and oil. To encourage investment, interest rates on bank loans have been cut, which has reduced the cost of financing investment. The overall liquidity situation was improved by lowering reserve requirements. Other sources of financing were from the budget, which increased the deficit levels. Oil exporting countries have been using previously accumulated resources from oil funds to pay for expansionary activities.

36. Table 3 summarizes a few impacts of the crisis and the responses of selected CSNs.

**Table 3. Country responses to the financial crisis**

<i>Country</i>	<i>Response</i>
Azerbaijan	Azerbaijan is experiencing the repercussions of global financial turmoil in the form of substantially weaker oil prices and heightened risk aversion towards emerging markets. Commercial banks find it much more difficult to raise capital abroad, and access of domestic companies and households to credit is being greatly reduced, dampening growth in the non-oil economy. Much weaker economic growth and lower oil prices will reduce budget revenue and, as a result of the Government's social spending commitments and ongoing infrastructure projects, deficit could increase. The National Bank of Azerbaijan (the central bank) has cut the refinancing rate by a further 2 percentage points, to 8 per cent, and has reduced reserve requirements for commercial banks from 9 per cent down to 6 per cent to improve liquidity.
Bangladesh	Bangladesh is expected to be adversely affected by the global downturn in 2009/10. The Government has declared poverty alleviation and the reduction of consumer prices to be its top priorities. Rising food prices is one of the main concerns of the poor. The Government has said that a commission will be established to keep prices under control. In terms of boosting investments, the Government has also promised to cut interest rates on bank loans. It will take steps to limit the impact of the fallout from the global financial crisis on exports and inflows of workers' remittances.
Cambodia	The economy remains heavily reliant on garment manufacturing, construction and tourism, and all three sectors have been shown to be vulnerable to the global economic slowdown. The Government has committed to maintaining Cambodia's rapid rate of gross domestic product (GDP) growth despite the global economic slowdown.
Kazakhstan	The authorities are attempting to combat liquidity problems in the banking sector and the slowdown in GDP growth. The Government has announced its Action Plan for 2009-10 (December 2008). The plan has five main components: (a) stabilizing the financial sector; (b) addressing issues in the real estate market; (c) supporting small and medium-sized enterprises (SMEs); (d) developing the agro-industrial sector; and (e) realizing industrial and infrastructural projects. The combined cost of the plan is estimated at 2.17 trillion tenge (\$17.4 billion), of which 1.2 trillion tenge will be financed through the National Fund of the Republic of Kazakhstan (the oil stabilization fund). In order to recapitalize the institutions and improve liquidity, the plan incorporates the purchase of stakes in Kazakhstan's four largest banks. It also envisages the use of the State holding company Samruk-Kazyna to channel funds to large industrial projects, as well as to SMEs that cannot obtain funding from banks.
Mongolia	Mongolia is increasingly feeling the impact of the global financial crisis. House prices have started to fall, banks are becoming more reluctant to lend, and the stock market has tumbled. Inflation, fuelled by expansionary fiscal policy, strong

	<p>import price pressures and increased consumption, reached 33.7 per cent year on year in August. The Government has set out its plan of action for the coming months. Much of its policy platform appears broadly expansionary. Key promises include creating 60,000 jobs, increasing pensions and other social welfare allowances, and maintaining the policy of cash payouts for those getting married and having children. Another key policy is to provide farmers with support to increase the domestic production of items such as milk, flour and vegetables, in a bid to reduce reliance on imports. Goat herders suffering from low world cashmere prices are to be offered subsidies and tax cuts. State investment projects will include: (a) investment in oil refining, as part of an effort to limit reliance on costly imports; (b) planned upgrades to road and air infrastructure; and (c) a new power plant for Ulaanbaatar.</p>
Tajikistan	<p>In recent years, the Government has broadly followed the reform prescriptions of the international financial institutions, enabling Tajikistan to record robust economic growth and stabilize its currency. In the short term, however, Government policy is likely to be dominated by crisis management, with Tajikistan reliant on the support of international aid agencies as it attempts to avoid a repeat of the energy and food crisis experienced in the winter of 2007/08. Tajikistan remains dependent on international aid for tackling issues of food supplies, infrastructure repair and capacity-building. For several years, the country has been pursuing a policy of keeping the budget deficit low to help contain external debt. Because of the energy crisis, which has continued intermittently throughout 2008, the Government is likely to place even greater emphasis on plans to develop the country's energy resources and infrastructure. To do so, it is pursuing a debt-based strategy, which includes large loans borrowed on concessional terms from China.</p>
Turkmenistan	<p>The Turkmen economy is relatively isolated from global financial markets, but has accumulated substantial international reserves from its gas exports in recent years. Nevertheless, its dependence on one commodity—gas—for revenue renders its growth prospects highly uncertain. The Government has established a stabilization fund aimed at protecting Turkmenistan from the global crisis. The fund will allocate money to socio-economic projects; it is, in effect, to be used as an extension of the budget.</p>
Uzbekistan	<p>Uzbekistan's relative isolation from global financial markets means that it should remain shielded from the worst consequences of the turmoil. However, the economy will be affected by the rapid downturn in Uzbekistan's main export markets, a fall in prices for its main commodity exports, and by a decline in remittances from Uzbek migrant labourers in the Russian Federation and Kazakhstan. The Government will therefore make greater efforts to boost growth in the face of external shocks, by expanding public investment with regard to infrastructure and industry, and by increasing wages and social payments.</p>

## **VI. INTERNATIONAL RESPONSES TO THE TRIPLE CRISIS**

### **A. The High-level Task Force on the Global Food Security Crisis and its Comprehensive Framework of Action**

37. In April 2008, on the recommendation of the Chief Executives Board of the United Nations, the Secretary-General established the High-level Task Force on the Global Food Security Crisis, bringing together relevant parts of the secretariat, United Nations agencies, funds, programmes and the Bretton Woods institutions to prepare a consolidated and coordinated action plan (Comprehensive Framework of Action (CFA)).<sup>8</sup>

38. The Framework was envisioned as a tool for setting up joint actions in regard to: (a) addressing current threats and opportunities emanating from food price increases; (b) avoiding future food crises by making relevant policy changes at the international and national levels; and (c) contributing to country, regional and global food security.

39. The framework outlines: (a) an analysis of the food crisis; (b) critical actions to urgently address threats and opportunities associated with the food crisis; and (c) practical ways of working together to achieve CFA outcomes at country, regional and global levels. Two sets of actions have been proposed for the implementation of the Framework. The first is focused on outcomes related to addressing immediate needs, namely: (a) enhancing emergency food assistance, nutrition interventions and safety nets and making them more accessible; (b) boosting smallholder farmer food production; (c) adjusting trade and tax policy; and (d) managing macroeconomic implications. The second set is aimed at achieving outcomes related to building resilience and contributing to global food and nutritional security, namely: (a) expanding social protection systems; (b) sustaining smallholder farmer food production growth; (c) improving international food markets; and (d) building international biofuel consensus. An additional outcome—strengthening global information and monitoring systems—is related to both sets of actions. Each outcome has a menu of actions from which to choose, as appropriate.

40. CFA also outlines implementation strategies, such as, among others, the establishment of country-level partnerships for food which build on existing mechanisms and programmes, ensure ongoing assessment and analysis, avoid duplication, identify gaps, review existing monitoring mechanism and promote effective public communications. It also addresses the financial implications of the food-security crisis, noting that studies have estimated the global incremental financial requirements for food assistance, social protection, agriculture development, budget and balance of payments support at between \$25 billion and \$40 billion per annum to maintain progress towards the achievement of Millennium Development Goal 1. Of these estimated amounts, one third would have to go towards financing immediate requirements for food assistance and two thirds towards expanding long-term agricultural capacity.

41. Under CFA, the High-level Task Force urges developing countries to allocate additional budgetary resources for social protection systems and to increase the share of agriculture in their public expenditure. In line with the intentions of developed countries to increase their official development assistance (ODA) to 0.7 per cent of gross national income, and the need for additional financial sources to sustainably improve food security, donor countries have been requested to double ODA for food

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<sup>8</sup> High-level Task Force on the Global Food Security Crisis, "Comprehensive Framework for Action" (2008), accessed from [www.ifad.org/operations/food/documents/cfa/cfa\\_draft.pdf](http://www.ifad.org/operations/food/documents/cfa/cfa_draft.pdf) on 12 February 2009.



assistance, other types of nutritional support and safety-net programmes. They have also been asked to increase the percentage of ODA to be invested in food and agricultural development from the current 3 per cent up to 10 per cent within five years (and beyond if needed) to reverse the trend of underinvestment in agriculture.

42. In the framework it is emphasized that increased allocations for food security should be additional to current funding levels and not divert resources from other critical social sectors necessary to achieve the Millennium Development Goals, such as education and health. Actions to achieve CFA outcomes will make use of institutional and financial systems to deliver at the country level, along the provisions of the Paris Declaration on Aid Effectiveness.<sup>9</sup>

### **B. Consolidated United Nations responses to the global financial crisis and CSNs: guiding principles**

43. Surges and volatility in the prices of food and fuel have caused substantial hardship and lowered living standards of the poor across the board. Many development gains, especially those related to achieving the Millennium Development Goals, have been under threat of reversal. This is particularly so in CSNs where, due to structural handicaps and narrow resource bases, it has been more difficult for Governments to implement effective measures to protect the poor. The situation has been exacerbated by the threat of global recession that has underpinned global growth. Protectionist pressures and credit contraction could further deepen such a recession. There is also a real concern that the impending recession will lead developed countries to reconsider their level of development assistance to poor countries, a phenomenon which could have serious repercussions for CSNs.

44. The Executive Heads of United Nations specialized agencies, funds and programmes, the World Bank and the International Monetary Fund recently came out with a wide-ranging assessment of the ongoing global crisis in financial markets and the resulting threat of recession.<sup>10</sup> The assessment contained the framework of a consolidated response of the United Nations system to the convergence of the crises, touching on trade, development, employment, finance, humanitarian assistance, the environment, and the protection of global goods and norms. The suggested steps are relevant to all developing countries, particularly CSNs.

45. The broad principles on which specific actions of the United Nations bodies will be based have been identified as follows:

(a) Immediate action is needed to protect people, jobs, shelter and livelihoods in order to alleviate the negative repercussions of the crises and thereby help prevent millions of people in poor countries from sliding back into extreme poverty;

(b) Actions are needed to ensure that momentum is generated to achieve an international agreement on climate change and to strengthen efforts in mitigation, adaption and technology transfer;

(c) The United Nations system must be vigilant, to ensure that poor and vulnerable communities do not become the casualties of this crisis;

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<sup>9</sup> Paris Declaration on Aid Effectiveness: Ownership, Harmonization, Alignment, Results and Mutual Accountability, adopted at the High-level Forum on the question of "Joint Progress towards Enhanced Aid Effectiveness: Harmonization, Alignment, Results", held in Paris from 28 February to 2 March 2005 (see <http://www1.worldbank.org/harmonization/PARIS/FINALPARISDECLARATION.pdf>).

<sup>10</sup> "Response of the United Nations Chief Executives Board to Global Financial Crisis" (SG/2144-ECO/135), accessed from [www.un.org/News/Press/docs/2008/sg2144.doc.htm](http://www.un.org/News/Press/docs/2008/sg2144.doc.htm) on 16 February 2009.

(d) All States should reaffirm their commitments to and pledges for development and humanitarian assistance. In the wake of the crises, ODA has become even more important to poor developing countries that face a lack of financial and balance-of-payments flexibility;<sup>11</sup>

(e) All states should resist protectionism and promote openness and inclusiveness as well as engagement in efforts to maintain long-term economic growth for the benefit of all;

(f) The regulatory failures that led to this crisis must be addressed urgently.

## **VII. THE WAY FORWARD: A REGIONAL RESPONSE**

46. To this point, the discussions in the present document have highlighted the need for addressing the food-fuel-financial crisis and climate change issues in a comprehensive and integrated manner. To address such issues, ESCAP and the Government of Indonesia jointly held a High-Level Regional Policy Dialogue in Bali, Indonesia on 9 and 10 December 2008. The Bali Outcome Document (E/ESCAP/65/15/Add.1), which was adopted at the meeting, contains areas of action that can be used to synchronize and reshape the development agenda in an appropriate manner, identify strategies for addressing the negative impacts of these crises, and prevent the crises from becoming a development emergency. The recommendations, along with the main messages of the Bali Outcome Document, are summarized below.

### **A. Crisis convergence**

47. Participants in the Policy Dialogue noted that the volatility of food and fuel prices posed a grave challenge to the Asia-Pacific region. The challenges have acquired a new dimension in the wake of the global financial crisis, threatening to inflict untold damage to human lives. The convergence of the three dimensions of the crisis must be addressed comprehensively. Otherwise, development gains achieved so far could be undermined.

### **B. The role of regional cooperation**

#### **1. Financial crisis**

48. The suggested modalities for regional cooperation to address the situation include: (a) strengthening existing mechanisms as well as establishing new mechanisms to support countries in balance of payments difficulties; (b) providing a channel for countries affected by the crises to receive budget financing assistance specifically for Millennium Development Goal-related activities; (c) improving surveillance of the financial markets to provide early warning of fragilities, vulnerabilities to financial shocks and contagion; and (d) addressing regulatory deficiencies to curb speculation in commodity markets.

49. There is a need for consultation among senior policymakers on monetary, fiscal and exchange rate policies. This would facilitate the mitigation of adverse

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<sup>11</sup> The need to provide developing countries with funds to stimulate economies, to provide social protection and to ensure the flow of liquidity to their firms was strongly recommended by the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System at its first meeting, held in New York 4-6 January 2009 (see "Recommendations for immediate action", available at [www.un.org/ga/president/63/commission/firstmeeting.pdf](http://www.un.org/ga/president/63/commission/firstmeeting.pdf)).

impacts of large swings in exchange rates due to erratic behaviour of the currency market, and serve as a step towards formal interregional exchange rate arrangements supported by an intraregional stabilization fund.

50. There is also a need to use ESCAP as a platform for forging greater regional cooperation in partnership with specialized agencies of the United Nations and other international and regional organizations in formulating and implementing effective social protection measures to protect the poor and other vulnerable groups.

## **2. Food security and sustainable agriculture**

51. There is a need for greater technical cooperation efforts to support capacity-building to strengthen national food security programmes, including the management of food stockpiles, the planning of agricultural land use and effective food information systems.

52. There is also a need for effective regional early warning systems, which can be used to coordinate agricultural information from member States on matters such as expected crop yields, floods and drought. Regional and subregional actions may also involve investment in effective food storage facilities/food banks, transport logistics and capacity development in establishing national agriculture insurance schemes.

## **3. Energy security**

53. There is a need for greater regional cooperation, including joint research and capacity-building measures, and the possibility of generating new financial resources to promote best practices and exchange of information in technology development and transfer with a focus on moving towards a low-carbon economy, reliable and sustainable energy supplies and energy efficiency by increasing the share of renewable energy and natural gas in the energy supply.

## **C. Conclusions**

54. The policies outlined in the Bali Outcome Document require commitment from the member countries, along with the participation of the private sector, academic and civil society organizations, as well as regional and international organizations. Because the crises are interrelated, these recommendations/actions must be implemented as a package, with slightly different priorities for different areas and modalities. The preparation of a feasible road map for implementing the Bali Outcome Document is a priority. ESCAP, as an inclusive regional organization and in consultation with the member States, could take up this task through appropriate modalities. The Commission may wish to review the recommendations and provide guidance on their implementation.

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