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Colombo, Sri Lanka**

**Spirit of Asia: Global Economic Recovery and Development Prospects**

**Concept Paper**

**Background**

The global economic downturn has highlighted the need for Asia to reduce its dependency on developed countries to diversify its markets, and the need to strengthen regional cooperation to take collective measures against future challenges. For Asia, a region which has a shared heritage dating back to the times of the Silk Route linking East Asia with Central, South and West Asia, as well as many other regions including Europe, this is not a new concept. Intra and inter regional trade helped bring about political and cultural integration thereby enabling interaction among groups of great diversity. The linkages established by the route facilitated foreign trade and political relations among the different nations in the region.

Asia's rapid economic growth since the 1960's has been remarkable by many standards. Fuelled by its resource endowments and economic dynamism, Asia's share of world GDP has risen over the years. Propelled by the fast rising economies of the region, its contribution to world GDP is close to 30 per cent<sup>1</sup> and it accounts to over one third of the world's total exports<sup>2</sup>. As a result, Asia is today witnessing a profound global economic and strategic power transformation.

Though the levels of development and integration differ within countries in the region, majority of the countries in Asia have been successful at integrating with the world economy. Aside from China and India that have emerged with strong growth rates, the rest of Asia has also grown considerably in the recent past. Asian countries have been promoting exports through a combination of policies such as relatively free trade, convertible currencies, macroeconomic stability, and innovative institutions (i.e. export processing zones, incentives

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<sup>1</sup> Calculated using IMF, 2007 data for ACD member countries.

<sup>2</sup> Calculated using IMF, 2008 data.

for foreign direct investment, etc). Exports and FDI inflows fuelled the growth rates of Asia, which in turn helped the region attain significant achievements in areas such as poverty reduction. Nevertheless, the current global economic downturn, which is the worst seen since the Great Depression of the 1930s, has temporarily halted the growth momentum of the region which could result in the deceleration of attaining development goals of the region.

### **Impacts of the Recession on Asia**

Prior to September 2008, developing countries were largely insulated from the financial turmoil since the kind of sophisticated financial instruments that were affected by the crisis were prevalent primarily in the financial markets of America and Europe. In fact, there was optimism that domestic consumption of emerging economies such as India and China was sufficiently strong for these and other developing economies to have ‘de-coupled’ from the fortunes of developed markets. However, as the crisis began to spread to the real sector, the likelihood of developing nations remaining immune diminished. Global trade was adversely affected, as were capital flows between developed and developing economies. Export oriented countries in Asia such as Singapore (3.7 per cent fourth quarter GDP contraction in 2008), South Korea (5.6 per cent contraction in GDP between the third and fourth quarter of 2008), Japan (4.3 per cent contraction in GDP in the fourth quarter of 2008) and ASEAN-5 (2.1 per cent growth in the fourth quarter of 2008) suffered substantial GDP losses largely due to a contraction in export demand<sup>3</sup>. Developing economies in Asia that are reliant on commodity exports also faced a downturn due to the crash in commodity prices – the Middle East is projected to grow at a substantially slower pace, while Russia is expected to contract by 6.5 per cent in 2009 according to the International Monetary Fund (IMF) projections. Other emerging economies which are heavily reliant on external financing have also suffered due to the freezing up of credit flows. The Asian Development Bank (ADB) has predicted that the average growth in developing Asia could decline to 3.4 per cent in 2009, the worst decline since 1998.

### **Asia’s Strengths and Development Prospects**

The economic recovery of developing Asia has been better than expected, and faster than predicted. In fact, Asia is one of the few regions in the world that is growing. Although Asian economies are expected to experience considerable slowdowns, their growth is projected to remain at or above rates observed during the Asian Financial crisis. India recorded a growth rate of 6.0 per cent during April-June of 2009 while China grew by 7.9 per cent<sup>4</sup> in the second quarter of the year. These emerging economies have been less dependent on developed countries for supporting their full recovery. Instead, domestic consumption and investment have played a more prominent role in the recovery process. Asian economies with large domestic markets have been able to manage the global economic crisis by increasing public expenditure to increase aggregate demand, and the size of their markets have been a strength in

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<sup>3</sup> IMF, April 2009.

<sup>4</sup> National Bureau of Statistics of China.

managing the crisis. While Asia is also in a position of strength, with a relative absence of financial sector imbalances and a generally healthy fiscal position, it needs to firmly establish itself as a key player in the global market and develop to its full potential so that it can increase the bargaining power of Asian countries and enhance Asia's economic competitiveness. The need for Asia to wean itself off its dependency on countries such as the US and EU countries has been highlighted, and in order to do so it is necessary to strengthen interdependence among Asian countries. It is possible to say that the global economic recession has changed the structure of the global economy, and has made Asia a stronger player in the international arena.

Asia has integrated into global capital markets, capturing close to half of the net private capital flows going to emerging markets. These capital inflows, combined with the region's current account surplus, have led to a large accumulation of foreign exchange reserves. These sizable reserves have helped Asia cushion the negative impacts of the crisis and have provided countries with the fiscal space to offer substantial fiscal stimulus packages to revive the fallen consumption and demand levels.

Asia's strengths also lie in its banking and financial systems which are now relatively robust after years of restructuring. As a result, bank asset quality, profitability and capital adequacy have improved over the past decade or so. Exposure of Asian banks to sub-prime and related products were limited. This together with improved balance sheets have helped the financial systems in the region to weather the current crisis and now Asia is better placed to partake in the region's development process.

Poverty incidence in Asia has also reduced significantly over the years. It has been estimated that since 1996, Asia has been able to lift around 300 million people out of poverty<sup>5</sup>. Individual countries have recorded significant achievements in reducing poverty levels in a relatively short span of time. For example, the proportion of the population living below US\$ 2 (Purchasing Power Parity) declined from 78.6 per cent in 1995 to 36.3 per cent in 2005 in China<sup>6</sup>. Growth has, in many emerging economies, stimulated a remarkable increase in per capita income and a decline in poverty rates. Despite the falling poverty rates, inequality levels have risen substantially in the region, propelled by the rural-urban income gap. In order to ensure that development gains are equally shared and development in rural areas takes place, the region should focus on inclusive development.

Furthermore, several other key factors need to be considered in order to successfully support Asia during its economic recovery. Mechanisms to support infrastructure development, encourage productive investment, and promote visible trade need to be developed. In order to re-balance growth in Asia, policies are required primarily in education and health care, which will support the broader objectives of poverty reduction and inclusive growth, which in turn will improve the standard of living in Asia.

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<sup>5</sup> Palanivel, 2009.

<sup>6</sup> ADB, 2009.

Given the rapid development process of many Asian countries, concerns regarding environmental deterioration and pollution have increased. Economically and industrially the region has been the world's fastest growing region. This has inevitably been accompanied by changing patterns of consumption, such as increases in energy consumption. China and India, which together accounted for 19 per cent of the world's total energy consumption in 2006, an increase from 10 per cent in 1990, will be the key world energy consumers in the future<sup>7</sup>. By addressing the environmental challenges that both population growth and economic growth pose, the region will be better placed to attain sustainable development in the future.

Some economies in the region are more vulnerable than others, with those with weaker macroeconomic fundamentals more susceptible to the negative impacts of the economic downturn. In this context, managing and monitoring of macroeconomic fundamentals are important. Also, the necessity to put in place social safety nets for economically vulnerable groups in society has been identified as crucial in order to support these groups. Programs which assist the vulnerable groups with micro-finance opportunities, social welfare, food stamps etc would, in the short term, help create a buffer zone whereby the negative impacts of the economic downturn do not push them into poverty.

Nevertheless, going against the odds, Asian economies emerged from prior crises to achieve progressive economic growth. Crises-affected economies in the region took action to rectify their macroeconomic imbalances and to address financial weaknesses. There is more prudent fiscal management, reduced external debt and more flexible exchange rate regimes. The much more healthy macroeconomic fundamentals of Asia have strengthened its resilience to the current crisis.

As regional interdependency has increased and Asia has emerged as a critical stakeholder in the global economy, a strong regional identity has been developed. This has led to the creation of common forums (i.e. ASEAN, ASEAN+3, APEC, SAARC) that address/respond as a collective body to challenges faced by the region as a whole. In this context, the role of ACD, whose main objective is to promote interdependence among Asian countries is crucial as it has in the last seven years brought 31 countries in Asia together. In promoting cooperation between these countries, ACD aims to build upon Asia's strengths and work towards positive cooperation. *Inter alia*, poverty alleviation, financial cooperation and human resource development are some of the key areas in which further cooperation is required. Deeper regional integration and cooperation would place Asia on an equal playing field with the rest of the world, to contribute to the world while empowering its own people.

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<sup>7</sup> Energy Information Administration, 2009.

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