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**Emerging Economic and Social Development Issues in
East and North-East Asia**

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Note by the secretariat¹

Summary

East and North-East Asia is the economic powerhouse in the Asian and Pacific region: it rests at the centre of policy and technology innovations that led the subregion to leapfrogging progress in economic and social development. However, the subregion also faces immense challenges to reverse the widening disparities between and within society and decouple environmental impacts from economic growth. Against this background, this paper reviews persistent and emerging challenges to advancing inclusive and sustainable development. Major challenges identified in this paper are also drawn from discussions among experts and representatives of member Governments in the course of developing the SRO programme of work for the biennium 2010-2011 and identifying work priorities in East and North-East Asia. In particular, this paper examines the implications of the identified challenges in the context of multilateral cooperation in the subregion.

¹ Issued without formal editing.

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Introduction

1. In an increasingly globalized world, trans-boundary cooperation has proven to be an essential tool for sustainable development. Regional and subregional cooperation mechanisms are important drivers in ensuring successful multi-lateral cooperation for regions and subregions, including East and North-East Asia. This paper identifies and highlights the advantages of East and North-East Asian economies' involvement in subregional cooperation initiatives.

2. In keeping with the objectives of the ESCAP Subregional Office for East and North-East Asia, namely to strengthen the geographic dimension of ESCAP's work in identifying subregional specific socio-economic and sustainable development issues, the analysis of cooperation between the subregional economies covers macroeconomic policy formulation and management, MDG related challenges and disparities, and economic growth through sustainable development. These three main areas are closely interlinked and each presents great opportunities for further strengthening economic and social cooperation.

I. Macroeconomic performance and policy challenges

A. GDP growth

3. In spite of the recent triple food, fuel and financial crisis, the countries of East and North-East Asia are expected to achieve high economic growth rates and to remain one of the fastest-growing subregions in Asia in 2010 and 2011 (table 1). After a sharp decline in 2009, the subregion saw a strong rebound in 2010, with manufacturing and exports returning to pre-crisis levels earlier than expected. However, economic activity steadily declined from its peak recorded in the first half of 2010 due to the slowdown in the global economic recovery and gradual reduction of government stimulus spending. This trend is expected to continue until 2011.

Table 1. East and North-East Asia: rates of economic growth 2007-2011

| | 2007 | 2008 | 2009 | 2010a/ | 2011b/ |
|---------------------------------------|--------|-------|--------|--------|--------|
| China | 14.2 | 9.6 | 9.1 | 10.0 | 9.0 |
| Democratic People's Republic of Korea | -1.2c/ | 3.1c/ | -0.9c/ | ... | ... |
| Japan | 2.4 | -1.2 | -5.2 | 2.8 | 1.8 |
| Mongolia | 10.2 | 8.9 | -1.6 | 7.0 | 7.1 |
| Republic of Korea | 5.1 | 2.2 | 0.2 | 6.3 | 4.0 |
| Russian Federation | 8.1 | 5.6 | -7.9 | 4.3 | 4.0 |

Sources: ESCAP, based on national sources, IMF, *International Financial Statistics databases* (Washington, D.C. August 2010); ADB, *Key Indicators for Asia and the Pacific 2010* (Manila, 2010; web site of the Interstate Statistical Committee of the Commonwealth of Independent States, www.cisstat.com, 21 July 2010 and ESCAP estimates.

Notes: a/ Estimates
b/ Forecasts (as of 14 September 2010)
c/ EIU online (accessed in September 2010)

4. China remained the main engine of growth for both the world and regional economies in 2010. For the last two decades, annual GDP of China has grown by average 9 per cent. GDP is expected to expand again by about 10 per cent in 2010 owing to the increase in exports and export-related investment which accounts for 15-20% of total investment. The domestic demand remains robust and industrial production and retail sales both grew more quickly in the second half of the year than in the first. In the second quarter of 2010, GDP of China grew by 10.3% and reached US\$1.34 trillion. Owing to its high growth rates, the country became the world's second-biggest economy. The economy has also become the biggest market in the world for cars and mobile phones and is expected to account for around one-third of global economic growth in 2010. China remains the world's biggest consumer of a number of different commodities such as iron ore and copper and energy.

5. According to the Economic Intelligent Unit, the economy of the Democratic People's Republic of Korea contracted by 0.9% in 2009 as compared to expansion of 3.1% recorded in 2008. The contraction of the economy was largely due to a fall in agriculture, mining and manufacturing sectors, as well as in wholesale and retail trade. The bad weather condition depressed agricultural production which made up one-fifth of GDP of the economy. Large fluctuations in GDP growth underline the inherent vulnerability of the economy to weather conditions. Moreover, the agriculture sector plays a key role in generating GDP and providing employment.

6. GDP growth for **Japan** is forecasted at 2.8 per cent in 2010, compared with a GDP fall of 5.2 per cent registered in 2009. The economy benefited from strong exports to China. However, the domestic demand remains sluggish as the economy continued to suffer from deflation. Gross public debt is rapidly approaching 200% of GDP, which is the highest level in the developed world. Proximity to China's booming economy has given

Japan a big advantage in its attempts to generate GDP growth. Government stimulus measures boosted growth in private consumption and fiscal consolidation began to benefit the economy. However, the appreciation in the national currency, the yen, in the mid-2010 made exports of capital goods and electronics more expensive for main importers. As a result, the GDP growth rate could slow down by the end of the year.

7. Hit by the global economic crisis, the **Mongolian** economy contracted by 1.6% in 2009 due to problems in the banking sector and a slowdown in construction. In 2010, the economy experienced unusually harsh winter which had a major adverse effect on the agricultural sector. However, the economy grew by 7.6% year on year in the first quarter 2010. This year, Mongolia and China signed an agreement on a US\$500 million to develop mining sector and infrastructure in Mongolia.

8. The Republic of Korea successfully responded to the global economic crisis. Backed up by its strong manufacturing sector and lessons learned from its financial crisis a decade ago, the export-driven economy managed to escape the downturn faster than any other nations in ESCAP region. GDP grew by 1.5% in the second quarter of 2010 on quarter-to-quarter basis owing to strong exports, increased consumer spending and growth in manufacturing and services outputs. As a result of the increase in merchandise exports the trade balance stayed in large surplus. However, the unemployment rate rose in the first half of 2010. GDP growth in 2010 is expected to reach 6.3%.

9. The Russian Federation is the only net exporter of oil and gas in this subregion and its economy is highly depended on hydrocarbons revenues. The return of the economy to growth in 2010 has been underpinned by the large stimulus package, an upturn in external demand, and lower interest rates. In the second quarter of 2010 GDP grew by 5.2% year on year owing to acceleration of domestic demand and a positive contribution of exports. Exports have appeared to be the driver of GDP growth in the Russian Federation. Real growth in domestic demand accelerated to 9.9% in the second quarter of 2010. Agriculture, however, was affected by the heat wave and wildfires. In August 2010, the government banned the export of grain until the end of the year in order to avoid a grain shortage.

B. Inflation

10. Inflation is expected to pick up at a modest and manageable rate in the East and North-East Asian economies in 2010. However, excess liquidity resulting from continued monetary easing could spill over into speculative asset price bubbles and the high frequency of meteorological events adversely affected food production this year which could lead to higher than expected food price inflation.

Table 2. East and North-East Asia: rates of inflation a/, 2007-2011

| | 2007 | 2008 | 2009 | 2010b/ | 2011c/ |
|--------------------|------|------|------|--------|--------|
| China | 4.8 | 5.9 | -0.7 | 3.1 | 3.3 |
| Japan | 0.1 | 1.4 | -1.4 | -0.5 | 0.3 |
| Mongolia | 9.6 | 28.0 | 8.0 | 7.3 | 5.3 |
| Republic of Korea | 2.5 | 4.7 | 2.8 | 3.0 | 3.2 |
| Russian Federation | 9.0 | 14.1 | 11.7 | 6.6 | 7.3 |

Sources: ESCAP, based on national sources, IMF, *International Financial Statistics databases* (Washington, D.C. August 2010); ADB, *Key Indicators for Asia and the Pacific 2010* (Manila, 2010; web site of the Interstate Statistical Committee of the Commonwealth of Independent States, www.cisstat.com, 21 July 2010 and ESCAP estimates.

Notes: a/ Changes in the consumer price index
b/ Estimates
c/ Forecasts (as of 14 September 2010)

11. Consumer price inflation in China is expected to average a modest 3.1% in 2010. However, there is a risk that rising food prices could force inflation higher than this level due to fast growth rate in the cost of grain. Floods along the Yangtze River system and in the North-East area of the country have devastated agricultural regions, including the province of Jilin, a major corn producer.

12. The consumer price index of Japan fell by 0.7% year on year terms in July 2010. The severity of the 2008-2009 recessions and the consequent widening of the output gap increased deflation pressure to the economy. The consumer prices are expected to fall by 0.5% by the end of 2010 in spite of higher global oil and commodity prices.

13. Consumer price inflation in Mongolia, which averaged 8% in 2009, has been rising rapidly in the first half of 2010 and reached 11.6% year on year in May 2010 owing to high public spending and rising prices for food notable meat. Other factors responsible for the surge include higher energy prices and higher rice prices. Inflation is heavily influenced by import prices, particularly food and oil prices. Although imported inflation will be partly offset by a strengthening of the togrog, the impact of a summer drought will lead to higher food prices in 2010. Healthy economic growth in 2010-2011 will also lead to a rapid elimination of the output gap, and supply bottlenecks will result in strong growth in prices for most consumer goods.

14. Inflation pressures remain moderate in the Republic of Korea in 2010, despite higher international commodity prices and strengthening domestic demand. Although the domestic and global economic recovery has reduced excess capacity in product markets, the manufacturers will continue to find it difficult to raise prices, owing to competition from other countries that make similar products for exports. The currency, the won, is expected to strengthen against the US dollar in 2010 relative to its value in the first half of 2009, helping to limit imported inflation. Consumer price inflation is expected to average 3.0% year on year in 2010 and will thus remain within the Bank of Korea's 2-4% target range.

15. The strengthening ruble, low import prices and sluggish demand have underpinned disinflation in the Russian Federation in the first half of 2010. The rate of growth in consumer prices declined to a new record low of 5.5% in July from 5.8% in June and 12% in July 2009. Underlying inflationary pressures are forecast to pick up in the second half of 2010 as a result of the deferred effect of loose fiscal and monetary policies. In addition, the severe drought and wildfires have had a devastating impact on agriculture. Despite a ban on grain exports until the end-2010, food prices are expected to be driven up during the remainder of 2010 and into 2011.

C. Major policy challenges

16. **Jobs and Income:** Labour market conditions in East and North East Asia generally showed improvement in 2010. Increasing export manufacturing activity coupled with job creation programmes of governments helped reduce excess production capacity in the market, pushing up wages as well as total employment. However, while official unemployment figures suggest that the region's labor markets were not particularly hard hit by the global economic crisis, there are certain worrisome trends in the labour market including the expansion of informal and vulnerable employment as well as youth unemployment. In order to reverse these trends, there is a need to prioritize and better target fiscal expenditure towards a job-rich recovery, through for example, supporting small businesses, and improving the alignment of skills with market demand through vocational training programmes.

17. **Exchange rate management and capital flows:** Subregional currencies have all gained against the dollar in recent months. While the appreciation of subregional currencies is in most part due to stronger economic fundamentals, speculative capital has also played a role in pushing up the value of these currencies. With loose monetary policy in the Western advanced economies, there is concern of excessive capital inflows to the region, which has relatively high interest rates. For example, at the onset of the debt crisis in Europe, the won of the Republic of Korea dropped 12% between April 26 and May 26, sparking fresh concerns about the impact of destabilizing capital flows on economic growth. In June 2010, the government responded with a measure to limit the accumulation of foreign exchange derivatives. Similarly, the recent interventions in the foreign exchange market by the Japanese government as well as the loosening of the dollar yuan peg by China all point towards the difficulties in balancing the need for long-term currency stability with the ability to manage external shocks and sustain economic growth, particularly for economies of East and North East Asia which are largely driven by external trade.

18. In addition, the subregional economies together accumulated close to 5 trillion dollars in foreign exchange reserves (approximately 50% of global foreign exchange reserves), mostly in the form of low yielding United States Treasury Bills. By redirecting part of these reserves back to investment projects (eg. infrastructure projects for improving physical connectivity in the sub-region) within the Asia-Pacific region, it can serve the purposes of earning better returns as well as expanding the market for exports by accelerating economic growth in the countries which benefit from these resources. However, foreign exchange reserves cannot be freed up for other use unless there is a regional mechanism for guarding against rapid reversals in capital flows.

19. To this end, there is a strong case for enhancing financial and monetary cooperation between the sub-regional economies to prevent and manage external shocks and enhance the efficiency of sub-regional resources.

20. **Fiscal and Monetary Policies:** During the economic crisis, the unprecedented coordination of fiscal stimulus packages and expansionary monetary policies was critical in arresting the downward spiral and initiating the process of recovery. The Russian Federation, Japan, Republic of Korea and China all have injected fiscal stimulus through infrastructure projects and investments in agriculture, education and health starting from 2008. The Japanese government even announced a fresh round of fiscal stimulus in September 2010 to boost economic activity. As a result, budget deficits have continued to increase and fiscal consolidation has become a clear necessity in some of these economies.

21. However, given the precarious nature of the current recovery, early and rapid withdrawal of stimulus measures may run the risk of triggering a double-dip recession, at the global scale. Therefore, coordinating policy actions of member countries and targeting fiscal spending towards areas that help boost private consumption (eg. social protection programmes) is required in order to protect growth and reduce poverty across developing countries in the sub-region. Tightening monetary policies across the subregion would also need coordination, since any mismatch between economies is likely to lead to significant fluctuation in exchange rates. So far, the subregional economies have shown extreme caution in raising policy rates, with China and the Republic of Korea tightening monetary policy very slightly to offset rising inflationary pressures. Mongolia has been more aggressive in increasing interest rates due to the return of double-digit inflation.

II. Poverty and inclusive development policy issues

22. The economic prosperity in the subregion lifted some people out of poverty while it left others on the margin. In fact, it is said to have widened the gap of wealth within a nation as well as across national borders. Among the socially and economically vulnerable groups which need effective policy interventions are women, youth, older persons, persons with disabilities, persons living with HIV/AIDS, migrants, and ethnic minorities. Elevating the socio-economic status of these groups is necessary for inclusive and sustainable development, and the quality of economic growth in this subregion. The paragraphs below describe the current situation and challenges with regards to some of these groups.

A. Gaps in MDGs

23. Even though East Asia can be generally categorized as an early achiever in many of the MDGs, a closer look at the MDG targets and indicators reveals East Asia as lagging behind in some Goals, most notably Goals 3 (gender) and Goal 6 (especially HIV/AIDS) (MDGs progress chart 2010). It is also worth noting that a great disparity exists between living conditions in the Democratic People's Republic of Korea and other countries of East and North-East Asia.

24. **Gender Equality:** Seen against the overall global progress on MDGs, East Asia is especially weak on gender indicators. Even though low representation of women in decision-making positions is prevalent throughout the world, the proportion of women in the national parliament in East Asia ranks 9th among 12 subregions of the world (pp.113, The World's Women 2010: Trends and Statistics). In the private sector, proportion of women in chief executive positions of enterprises are extremely low in this subregion, with 4% in the Republic of Korea, compared with 32% in Thailand and 48% in the Philippines (pp.124, The World's Women 2010: Trends and Statistics).

25. Promoting gender equality and empowering women relate to all spheres of life in the society, and therefore need a comprehensive approach. Gender mainstreaming is one of the focuses of ESCAP's work towards inclusive and sustainable development in Asia and the Pacific. Gender equality is also at the heart of the United Nation's development strategy at the global level. One opportunity for connecting the subregional stakeholders towards gender equality in East and North-East Asia is the Secretary General's initiative "Unite to End Violence Against Women", a global campaign due to be launched in the Asia-Pacific in late November, as violence against women is one of the harshest manifestations of gender inequality in a society.

26. **HIV/AIDS:** Another MDG-related area which continues to be a challenge for the subregion is HIV/AIDS. Contrary to the world trend, the rate of new infection is rising in the Republic of Korea and Japan, especially among the young population under 30 years old. In fact, the Republic of Korea and Japan, together with the United Kingdom, are the only developed countries in the world where the rate of new HIV infection is on the rise. This is largely due to the lack of adequate education on sexually transmitted infections. New infection rate is said to be rising slightly in Mongolia, and the epidemic is said to have been outgrowing the response efforts in China. While taking note of some inconsistency in data and of a wide disparity within the country, HIV infection cases seem to be increasing in the Russian Federation.

27. In order to reverse the trend, education on sexual health needs to be strengthened, and confidential medical service and advice should be made available for young people. Ensuring universal access to medical services and medications for those living with HIV/AIDS is also necessary. In addition, the elimination of entry restrictions, at the national border, for

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