

The Asia Pacific region has become an engine of global growth

Asian Economies Chart New Paths

Emerging macroeconomic issues will affect the way the Asia Pacific does business – including travel and tourism

The future of Asia Pacific economies was discussed at two recent annual meetings, that of the Asian Development Bank (ADB) last month in Hyderabad and the annual meeting in April of the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) in Jakarta.

This edition of *Issues & Trends* focuses on the issues raised and their potential impact on the travel and tourism industry. It is a synthesis of the publicly available material posted on the organisations' websites: www.adb.org and www.unescap.org.

OVERVIEW

The Asia Pacific region has become an engine of global growth. Although the United States and Europe will continue to remain important, China (PRC) and India are growing their respective profiles and relevance to the global economy. Asia is boosting its share of the world's GDP and trade. In the future, Asia will consume more food and more energy, demand better infrastructure and seek improved services.

While there is a demand for more products and services, and poverty levels are falling, new issues are emerging:

- The gap between rich and poor is widening. Many people still do not have access to basic services such as clean water, sanitation, education and health care.
- Economic growth and development is taking a heavy toll on the environment.
- There is still a high level of risk arising from fiscal regulatory weaknesses, policy uncertainty and market distortions.

A LOOK AT HISTORY

In his opening address at the 39th annual general meeting of the ADB, Indian Prime Minister Manmohan Singh, an economist by profession, suggested that Asia "needs to look back to take stock of the lessons of the Asian financial crisis" that struck in 1997. He said, "With the benefit of hindsight, we now know that the crisis arose due to four important factors":

- Exchange rates were pegged at unsustainable levels;
- The fragility of financial systems allowed enterprises to borrow without any regard for mismatches in currency composition or maturity profile;
- The regulatory infrastructure, especially in the financial sector, was flawed; and
- Government systems for monitoring the quantum and nature of capital flows were found to be inadequate.

Although post-crisis analysis has addressed a number of additional issues, such as the preconditions for capital account convertibility and the relative merits of fixed versus floating exchange rates, Mr Singh said it was necessary to focus on the main lessons, as outlined below:

- International financial institutions need to provide effective, quick and credible responses in the event of a crisis, such as the Asian financial crisis of the late 1990s. He said, "Half-hearted measures do not resolve the problem; they only aggravate it further."

Asia's economies are less fragile than they were to ride the wave of currency appreciations

- Such financial crises can be contagious. "In panic situations, markets do not adequately discriminate between countries with strong and weak economic fundamentals and seemingly strong economies can also be engulfed by a snowballing crisis."
- Continuous monitoring of the economy is very important. This requires: 1) credible systems for gathering, monitoring and disseminating information to markets and regulators; 2) international standards for economic management; and 3) competent and effective regulatory systems for enforcing those standards.

GLOBAL PAYMENT IMBALANCES

In a little less than a decade, Asia's external payments pendulum has swung from large current account deficits and worrisome external debts to equally large current account surpluses and unprecedented international reserves; however, there is a downside.

According to ADB President Haruhiko Kuroda, huge disparities have emerged in the current account positions of different countries. In 2005, the current account deficit of the United States stood at US\$805 billion, or about 6.4% of its GDP. In the same year, the current account surplus of Japan was US\$163.9 billion, that of China (PRC) was US\$158.6 billion and that of the Middle Eastern countries US\$196 billion.

According to Kuroda, "Large disparities raise concerns about unsustainability and provoke the fear of hard landings. The process of correcting imbalances can be disruptive if it is sudden and unexpected. The present level of global imbalance cannot be sustained forever. It therefore calls for action both from countries having current account surpluses and those having current account deficits."

ASIAN CURRENCIES RISING, DOLLAR DECLINING

The overall view is that Asia's economies are less fragile than they were in previous years and in a much better position to ride the wave of currency appreciations. Rising currencies bring more spending power while providing shelter from rampant commodity costs. Moreover, the changes may break dependency on the US market and help form a more resilient regional economy.

"This is going to be positive for the Asian economies," Kevan Watts, Chairman of Merrill Lynch International, told the reporters from the ADB conference publication *Emerging Markets*. "The declining dollar will help Asia stand on its own feet."

Chinese Vice Finance Minister Li Yong strongly rebutted demands that the yuan be given more flexibility. The delicate

balance that Chinese government is trying to create in the economy could collapse if exchange rate moves are not closely controlled, he argued. Meanwhile, representatives of the Malaysian, Indonesian and Philippine governments noted that their currency appreciations were orderly, sustainable and beneficial to reducing debt and encouraging investment.

ASIAN CURRENCY INTEGRATION

One measure to reduce exposure of the Asia Pacific region to currency volatility may be greater currency integration. Finance ministers of ASEAN (Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam), China (PRC), Japan and Korea (ROK) agreed to take over the ADB's plan to launch an Asian Currency Unit (ACU), an index of regional currencies, and to subject it to detailed scrutiny.

The plan has been opposed by the United States, which sees it as a first step toward an Asian common currency that could threaten the dollar. However, the head of the ADB's Office for Regional Economic Integration, Masahiro Kawai, welcomed the ASEAN+3 initiative on the ACU and pledged full support and co-operation in the ministerial study.

The ministers also pledged to consider the possible "multi-lateralisation" of the regional network of currency swaps known as the Chiang Mai Initiative (CMI) that are designed to support countries facing a short-term liquidity crisis. They also resolved to bolster economic surveillance amongst their respective countries.

Korean Finance Minister, Han Duck Soo, stressed that this would be done "in conjunction" with the IMF. However, the ASEAN+3 ministers urged IMF Managing Director Rodrigo de Rato to come up with concrete proposals to boost Asia's say in the IMF by the time of their annual meeting in Singapore in September.

ASIAN ECONOMIC INTEGRATION

Asian countries are also working to boost regional trade co-operation and integration. East Asia is leading the way. Driven by the emergence of global value chains, cost reductions, rapid technological progress, and trade and investment liberalisation, intra-regional trade in East Asia now accounts for well over half of the region's total trade.

India's "Look East" policy has also marked a strategic shift in India's global perspective, linking India into a web of partnerships with the members of ASEAN and East Asia through free trade and

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economic co-operation agreements. Prime Minister Singh foresees an Asian free trade area covering all major Asian economies and possibly extending to Australia and New Zealand. "This Pan-Asian FTA could be the future of Asia," he said.

He pointed out that India has also set up a study group to pursue greater economic co-operation with China (PRC), including a possible free trade agreement. "There are immense untapped opportunities for trade and economic co-operation between our countries," Singh told *Emerging Markets*. The Indian and Chinese finance ministers also met during the ADB meeting to discuss trade, financial dialogue and investment issues.

INFRASTRUCTURE FINANCING

Adequate infrastructure in the four key sectors of transport, telecommunications, energy and water is considered by UNESCAP to be a prerequisite for opening up access to global trade and investment flows, increasing competitiveness of production and services, making economic growth more inclusive for remote areas and landlocked countries, and enabling the delivery of health, education and other services.

As many of these sectors are cross-boundary, UNESCAP is proposing more regional co-operation. The most important requirement will be greater innovation in financing infrastructure development.

Asia Pacific governments have long financed such development largely from public funds. Now, the growing fiscal stress is forcing governments to look for alternative sources. In the past, the private sector held back because of high capital costs, long lead times, slow returns on investment and vulnerability to fluctuating political and economic circumstances. Today, however, private sector interest in, and incentives for, participating in the building, operation and financing of infrastructure projects has increased with the liberalisation of markets and investment flows.

Potential new sources of capital include the region's surplus savings and possibly foreign exchange reserves. UNESCAP says Asia Pacific countries need to co-operate in developing mechanisms for accessing these funds through cross-border financial intermediation.

Another possible source of capital is to set up an Asian investment bank, similar to the European Investment Bank, an institution that lends substantially more than the ADB. An Asian investment bank could specialise in infrastructure financing, raise funds mainly from capital markets and provide medium-term

loans and guarantees for the region's developing countries. Such an institution could be owned by UNESCAP member countries and regional and multilateral development banks. Selected private banks could also be invited to join, reflecting the spirit of public-private partnerships.

MEETING ENERGY NEEDS

Meeting the energy needs of the Asia Pacific countries in a sustainable manner is a huge challenge. Concerns have grown about energy security in the wake of the recent volatility and rise in oil prices, driving renewed efforts to reduce energy usage and to develop renewable and alternative energy sources, especially in the automotive sector.

Another major challenge is to improve access to modern energy supplies at affordable prices. At the same time, the environmental impacts of conventional energy and traditional fuel use are becoming unsustainable. Addressing these challenges effectively will require collective and co-ordinated action by governments, producers, consumers, regulators, and the development community. Given the diversity of supply and use of energy resources in different countries, there is also growing recognition of the benefits of a regional approach to developing electricity markets, promoting energy trade and creating regional power grids.

Central Asia is emerging as a major supplier of future Asian energy needs. The construction of multibillion-dollar oil and natural gas pipelines in that region will increase energy stability and supplies for the Asia Pacific region as well.

WEAK JOB CREATION

In spite of economic growth, there are an estimated 500 million unemployed or underemployed in Asia. Rana Hasan, an ADB economist, argues that while economic growth was vital for generating new jobs, the recent experience from the region showed disappointing employment trends, reflecting weak growth in wages for many, worsening income and expenditure distributions.

Mr Hasan also called for more attention to the adverse effects that the adoption of new technologies may be having on the demand for labour, especially unskilled labour. He was careful to point out that he was not recommending that new technologies not be adopted; instead, he called for focus on designing and implementing appropriate human capital policies and social protection systems.

William Lewis, Director Emeritus at the McKinsey Global Institute, argued that all too often, governments have put too many regulatory barriers on the private sector and to their entry into new fields. He cited the Indian automobile industry, which, when unshackled from various regulations, saw output growth of 280% between 1992-1993 and 1999-2000. Similar gains could be had in other sectors once the business environment was improved.

Duncan Campbell, Director of the Policy Integration Department, International Labour Office (ILO), suggested that the improved mobility of capital and intense international competition were putting pressure on labour markets. Ways would have to be found to balance firms' need for flexibility with the need for security among workers through social insurance-type mechanisms.

INVOLVEMENT OF NGOS AND CIVIL SOCIETY

One highlight of the ADB annual meeting was "the very large turnout of NGOs and other civil society groups" that have been among the bank's biggest critics. The ADB says it "remains committed to working with our civil society partners to promote economic growth that is pro-poor, socially inclusive and environmentally sustainable."

Mr Kuroda says that in India, dozens of civil society organisations are participating in ADB-financed projects to restore livelihoods in disaster-prone regions, increasing community involvement in infrastructure development, cleaning up polluted sites, and providing education, health services and microfinance.

Lauding the "great results from such partnerships," he said, "similar collaboration is necessary at all levels to give the Asia and Pacific region the best possible chance of attaining the Millennium Development Goals." He said the bank would soon make more funds available for NGO-led initiatives against HIV and AIDS and provide grants to NGOs undertaking anticorruption activities. He also pledged to solicit NGO views on the bank's environment policy and consult with them on a review of the energy policy.

CHALLENGES OF GLOBALISATION

The suddenness and severity of the Asian financial crisis dented the world's confidence in globalisation. Today, the crisis has passed, and these economies are all back on track.

However, as Md Ismail Zabihullah of the Bangladesh central bank, said, "The euphoria surrounding globalisation seems to be waning as the champions of globalisation have, in recent times, expressed doubts as to its effect on their industries and employment. We still believe in the process of globalisation but at our own pace and convenience based on realities on the ground.

The process should move forward by providing weaker countries better access to developed markets, as well as by augmenting the flow of overseas development assistance to facilitate investment in critical sectors of the economy."

Some Asian countries are also concerned about the way their economies are scored by 'ratings agencies' such as Moody's, Standard & Poor's and Fitch. Philippine finance secretary Margarito Teves, seeking to reduce payments on his country's US\$76 billion debt, vowed to step up pressure on credit ratings companies to reassess the nation's status. He argues that ratings agencies should pay less attention to a legacy of accumulated debt and reward the government for the implementation of an ambitious public finance framework.

According to Indian Prime Minister Singh, the future of Asia lies in addressing the imbalances in the system. He said, "The challenge before Asia today is to create and maintain a regional and international environment that is conducive to maintenance of high economic growth on a sustainable basis." He cited the need for ensuring equity, social justice and addressing regional imbalances in the growth process so as to reduce the income gap between rural and urban areas.

He noted: "For the past quarter century, or more, Asia is once again on the move. Millions of people in our region have been liberated from poverty, ignorance and disease. If we can sustain this growth process and ensure that it is equitable, we can banish poverty for all times to come. If we can pursue economic development in the framework of an open economy and an open, democratic society, we would have succeeded in restoring to Asia its ancient glory as the land of great knowledge, wisdom, creativity and compassion."

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