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In conformity with the practice followed by other international organizations, this issue of the *Survey*, published in 1995, has been titled *Economic and Social Survey of Asia and the Pacific 1995*. It marks a break with the past practice of using the year preceding the actual year of publication in the title. Hence there will be no issue of the *Survey* under the title *Economic and Social Survey of Asia and the Pacific 1994*.

FOREWORD

The *Economic and Social Survey of Asia and the Pacific 1995* is the forty-eighth in the series of the annual *Surveys* prepared by the secretariat on economic and social development in the ESCAP region. Besides providing information on recent developments, the *Survey* analyses selected policy issues of current concern. Accordingly, this issue focuses upon the reform and liberalization of the financial sector as an important part of macroeconomic reforms, and social security as a policy tool for mitigating some of the social problems facing the region.

The findings in this issue confirm the continuing strong economic growth in the developing ESCAP region which achieved an average rate of 7.7 per cent of GDP growth in 1994, compared with 7.2 per cent in 1993. Comparable rates of growth are also projected for 1995 and 1996. There has been a narrowing in the differential in economic performance among the diverse groups of economies in the region with improved accomplishments in South Asian as well as some of the least developed countries. Thus, while the average growth rate of both East and South-East Asian economies in 1994 increased only marginally, that of the South Asian economies registered an improvement by nearly a full percentage point. The performance of the least developed countries also improved by a similar magnitude.

However, many of the least developed, small island and disadvantaged economies in transition are yet to establish a firm foundation for sustained growth with stability. The Central Asian republics are still experiencing overall output decline along with high rates of inflation, although the rate of decline has slowed in some cases.

Economic reforms involving both the real and financial sectors are a continuing process. There has been an acceleration of such reforms over the past decade with the objectives, *inter alia*, of enhancing domestic systemic efficiency and improving international competitiveness. While recent policy reforms in individual countries are touched upon in the analysis of macroeconomic performance, the *Survey* especially focuses on the reform and liberalization of the financial sector. The measures implemented in this area aim at the reduction of barriers to entry into financial markets, deregulation of interest rates, reduction in or elimination of directed credit programmes, development of new financial instruments, liberalization of the external financial sector, and improvements in regulatory frameworks for more effective prudential management. The analysis points to the likelihood of efficiency gains resulting from the reforms as well as to the new policy challenges emerging from a more open financial sector. Particularly highlighted are the problems faced in maintaining domestic macroeconomic stability while sustaining openness to volatile international capital flows.

Despite the rapid pace of economic growth, the region remains beset with many social problems. The *Survey* reviews social security provisions on such issues as financial security in old age, benefits for invalidity, employment injury, sickness, maternity, and medical care. The review indicates that social security coverage in the region remains rather limited. The beneficiaries are mostly those employed in the organized sectors while the poor and vulnerable segments of the population are largely excluded. Some of the problems and policy options for future expansion are also analysed.

As in the past, the *Survey* is published on the sole responsibility of the ESCAP secretariat. The views expressed do not necessarily reflect those of the members and associate members of ESCAP.

Seiko Takahashi
Acting Executive Secretary

March 1995

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The term "ESCAP region" is used in the present issue of the *Survey* to include Afghanistan, American Samoa, Armenia, Australia, Azerbaijan, Bangladesh, Bhutan, Brunei Darussalam, Cambodia, China, Cook Islands, Democratic People's Republic of Korea, Fiji, French Polynesia, Guam, Hong Kong, India, Indonesia, Iran (Islamic Republic of), Japan, Kazakhstan, Kiribati, Kyrgyzstan, Lao People's Democratic Republic, Macau, Malaysia, Maldives, Marshall Islands, Micronesia (Federated States of), Mongolia, Myanmar, Nauru, Nepal, New Caledonia, New Zealand, Niue, Northern Mariana Islands, Pakistan, Palau, Papua New Guinea, Philippines, Republic of Korea, Samoa, Singapore, Solomon Islands, Sri Lanka, Tajikistan, Thailand, Tonga, Turkmenistan, Tuvalu, Uzbekistan, Vanuatu and Viet Nam. The term "developing ESCAP region" excludes Australia, Japan and New Zealand.

The term "the Central Asian republics" in this issue of the *Survey* refers to Armenia, Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan.

The designations employed in this publication do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country or territory or of its authorities, or concerning the delimination of its frontiers.

Mention of any firm or licensed process does not imply endorsement by the United Nations.

The abbreviated title *Survey* in footnotes refers to *Economic and Social Survey of Asia and the Pacific* for the year indicated.

Many figures used in the *Survey* are on a fiscal year basis and are assigned to the calendar year which covers the major part or second half of the fiscal year.

Reference to "tons" indicates metric tons.

Values are in United States dollars unless specified otherwise.

The term "billion" signifies a thousand million.

In the tables, two dots (..) indicate that data are not available or are not separately reported, a dash (–) indicates that the amount is nil or negligible, and a blank indicates that the item is not applicable.

In dates, a hyphen (-) is used to signify the full period involved, including the beginning and end years, and a stroke (/) indicates a crop year, a fiscal year or plan year. The fiscal years, currencies and 1994 exchange rates of the economies in the ESCAP region are listed in the following table:

Country or area	*Fiscal year*	*Currency and abbreviation*	*Mid-point rate of exchange for $1 as of June 1994*
Afghanistan	21 March to 20 March	Afghani (Af)	50.600
Armenia	..	Drum	400.000
Australia	1 July to 30 June	Australian dollar ($A)	1.372
Azerbaijan	1 January to 31 December	Manat	1,080.000
Bangladesh	1 July to 30 June	Taka (Tk)	40.250
Bhutan	1 April to 31 March	Ngultrum (Nu)	31.370
Brunei Darussalam	1 January to 31 December	Brunei dollar (B$)	1.510[a]
Cambodia	1 January to 31 December	Riel (CR)	3,496.000[bc]
China	1 January to 31 December	Yuan renminbi (Y)	8.653
Cook Islands	1 April to 31 March	New Zealand dollar ($NZ)	1.682
Democratic People's Republic of Korea	..	North Korean won (Won)	..
Fiji	1 January to 31 December	Fiji dollar (F$)	1.459
Guam	1 October to 30 September	United States dollar ($)	1.000
Hong Kong	1 April to 31 March	Hong Kong dollar (HK$)	7.729
India	1 April to 31 March	Rupee (Rs)	31.370
Indonesia	1 April to 31 March	Rupiah (Rp)	2,160.000
Iran (Islamic Republic of)	21 March to 20 March	Rial (Rls)	1,751.690
Japan	1 April to 31 March	Yen (¥)	99.050
Kazakhstan	1 January to 31 December	Tenge	6.000
Kiribati	1 January to 31 December	Australian dollar ($A)	1.372
Kyrgyzstan	1 January to 31 December	Som	12.600
Lao People's Democratic Republic	1 July to 30 June	New kip (NK)	719.000[b]
Macau	..	Macau pataca (MOP)	7.961
Malaysia	1 January to 31 December	Ringgit (M$)	2.603
Maldives	1 January to 31 December	Rufiyaa (Rf)	11.820
Mongolia	1 January to 31 December	Tugrik (Tug)	408.000
Micronesia (Federated States of)	..	United States dollar ($)	1.000
Myanmar	1 April to 31 March	Kyat (K)	5.924
Nauru	1 July to 30 June	Australian dollar ($A)	1.372
Nepal	16 July to 15 July	Rupee (NRs)	49.350
New Zealand	1 April to 31 March	New Zealand dollar ($NZ)	1.682

Country or area	Fiscal year	Currency and abbreviation	Mid-point rate of exchange for $1 as of June 1994
Niue	1 April to 31 March	New Zealand dollar ($NZ)	1.682
Northern Mariana Islands	..	United States dollar ($)	1.000
Pakistan	1 July to 30 June	Rupee (PRs)	30.610
Palau	..	United States dollar($)	1.000
Papua New Guinea	1 January to 31 December	Kina (K)	0.945
Philippines	1 January to 31 December	Peso (P)	26.910
Republic of Korea	1 January to 31 December	Won (W)	805.500
Samoa	1 January to 31 December	Tala (WS$)	2.510
Singapore	1 April to 31 March	Singapore dollar (S$)	1.524
Solomon Islands	1 January to 31 December	Solomon Islands dollar (SI$)	3.292
Sri Lanka	1 January to 31 December	Rupee (SL Rs)	49.305
Tajikistan	1 January to 31 December	Russian rouble (R)	1,805.000
Thailand	1 October to 30 September	Baht (B)	24.990
Tonga	1 July to 30 June	Pa'anga (T$)	1.367
Turkmenistan	1 January to 31 December	Manat	2.000
Tuvalu	1 January to 31 December	Australian dollar ($A)	1.372
Uzbekistan	1 January to 31 December	Russian rouble (R)	1,740.000
Vanuatu	1 January to 31 December	Vatu (VT)	115.850
Viet Nam	1 January to 31 December	Dong (D)	11,063.000[b]

Sources: United Nations, *Monthly Bulletin of Statistics*, vol. XLVIII, No. 12 (December 1994); United Nations, *Statistical Indicators for Asia and the Pacific*, vol. XXIV, No. 4 (December 1994); and national sources.

[a] 21 July 1994. [b] 9 September 1994. [c] Official visitor's rate.

ABBREVIATIONS

ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of South East Asian Nations
BIS	Bank for International Settlements
CEPT	Common Effective Preferential Tariff
CIS	Commonwealth of Independent States
CPF	Central Provident Fund
CPI	consumer price index
DAC	Development Assistance Committee
EPF	Employee Provident Fund
EU	European Union
FDI	foreign direct investment
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GNP	gross national product
GST	general sales tax
IDA	International Development Association
ILO	International Labour Organization
IMF	International Monetary Fund
IRDP	Integrated Rural Development Programme
MEGSAT	Mass Employment Generation through Science and Technology
MFA	Multifibre Arrangement
MFN	most favoured nation
NAFTA	North American Free Trade Agreement
NGOs	non-governmental organizations
NMP	net material product
NSTEDB	National Science and Technology Entrepreneurship and Development Board
ODA	official development assistance
OECD	Organisation for Economic Co-operation and Development
PPI	producer price index
SAARC	South Asian Association for Regional Cooperation
SAPTA	South Asia Preferential Trading Arrangement
SDRs	Special Drawing Rights
SPARTECA	South Pacific Regional Trade and Economic Cooperation Agreement
UNCTAD	United Nations Conference on Trade and Development
VERs	voluntary export restrictions
WTO	World Trade Organization

I. WORLD ECONOMIC DEVELOPMENTS AND THE ESCAP REGION

The pattern of recent economic development in the world points to a significant change in the nature of interdependence in the world economy. While the developing countries in the past mostly reacted passively to the level of economic activity in the developed world, it would now appear that these countries, particularly those in the ESCAP region, are beginning to exercise their own independent influence on the world economy. The continuing strong growth in the developing ESCAP region despite protracted recession in most industrial countries has shown that the economic growth process in the region has developed an internal dynamism and resilience that can survive strong external shocks transmitted from the rest of the world economy. Nevertheless, the region's development will continue to be affected by global developments in such important areas as trade, investment, technology and financial flows.

The developing ESCAP region still makes up a relatively small part of the world economy with around 10 per cent share of global gross domestic product (GDP), although its interface with the world economy via trade and investment linkages is much more significant, and growing. It accounts for about 15 per cent of world trade and its share in foreign direct investment (FDI) inflow is still larger with over one fourth of the global aggregate and nearly two thirds of the inflow to developing countries. The region's share in other international financial capital flows is also similarly high. With the inflows of such financial and investment capital come a variety of technological inputs. The region's linkage with the world economy is further strengthened by the millions of its people working around the world. They remit billions of dollars annually which add to domestic incomes and provide substantial support to the balance of payments of home countries.[1]

The market-oriented economic reforms being implemented by virtually all economies of the world, and international accords such as those reached under the Uruguay Round of multilateral trade negotiations to establish more liberal trade, investment and technology policy regimes, are expected to strengthen further the international linkages of individual economies by facilitating international flows of goods and services, capital, labour and technology in the coming years. The developing countries of the ESCAP region have vigorously pursued their own domestic reform programmes and actively participated in negotiations to bring the Uruguay Round to a successful conclusion with wide-ranging agreements on international trade and related issues. These developments are expected to intensify the impact of global developments on the performance of developing economies of the region, and make their own impact felt more strongly in the world economy.

At the present stage of their development, all developing countries of the region still need substantial external inputs of capital, technology and finance. Their individual needs, however, vary widely reflecting differences in economic structures, stages of development, and the indigenous capacity for policy reforms and implementation. While some of the countries are now both recipients of and contributors to global investment, capital and technological flows, many of the others remain heavily dependent on external inflows. There are also differences among countries with regard to their ability to access different channels of such inflows. Thus, some countries are well poised to take advantage of these flows in response to

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1 Global estimates of 80 million people living outside their country of citizenship in the mid-1980s have been cited. A $36.7 billion net remittance flow to developing economies in 1990 has also been estimated. The ESCAP region could account for at least one third of these numbers. Annual gross outmigration from the region could be estimated at least at one million. See United Nations Conference on Trade and Development (UNCTAD) and the World Bank, *Liberalizing International Transactions in Services: A Handbook* (United Nations, New York and Geneva, 1994) pp. 17-19. Rashid Amjad, "The dynamics of Asian labour migration" in *Present Issues of International Migration* (The Japan Institute of Labour, Tokyo 1992), pp. 19-43.

market forces, while many others have very little choice other than to rely on official sources of financial and technical assistance.

The following is a brief discussion of the recent trends and events in the world economy from the above perspective.

RECENT GROWTH PATTERNS IN THE WORLD ECONOMY

In 1994, the gross world output was expected to grow by 2.2 per cent compared with a growth rate of 1.2 per cent recorded in 1993 (table I.1). Growth in world output has thus outpaced world population growth for the first time since 1989. Current projections indicate a further strengthening of growth to 3 per cent in 1995. That may finally signal the end of the sharp slow-down in world economic activity since 1990. Over the past several years, the economic slow-down mainly affected the industrial countries which, however, together account for three fourths of world GDP. The level of economic activities in the industrial countries and the associated import demand serve as important mechanisms for the transmission of the growth impulse in the world economy to the developing world. In this context, it may be noted that the G7 countries alone provide markets for about 65 per cent of developing country exports. A steep decline in output, largely due to a number of structural reasons in the economies in transition in eastern Europe and the former Soviet Union, including the Central Asian republics, occurred in the midst of the recession in industrial countries, further limiting the growth in world output. The time pattern and pace of the recessionary slow-down in individual economies differed. This attenuated the adverse impact of recession in the industrial economies on the overall performance of the world economy.

Among the developing countries, while the overall growth of 4.8 per cent in 1994 was impressive, although somewhat less than the 5.1 per cent of 1993, the regional pattern of growth has been highly uneven. The poorer African countries, with their mainly commodity-based export trade and other structural limitations, were the least well-placed to cope with the impact of the recession. Their extremely slow rates of recent economic growth reflected, among other things, their vulnerability to exogenous fluctuations. The oil exporters, after a sudden surge in oil prices in the wake of the Persian Gulf war, suffered a relapse into slow growth as oil prices declined largely because of the recession. The Latin American countries were slowly emerging out of the debt crisis through a process of structural adjustment. The recession apparently slowed their recovery and made it more difficult, but it has not totally deflected the course of recovery.

The developing economies of the ESCAP region emerged largely unscathed with continuing strong economic growth in many parts of the region. Apart from the moderating effect of the unsynchronized pattern of recession in the major industrial countries, the region's escape, by and large, from a more severe impact could be attributed to the growing strength of domestic markets, intraregional trade and investment links, and the competitiveness of exports from the region which are now well diversified into a variety of manufactures.

As was the case with the slow-down and recession, the pace and time pattern of recovery in the industrial economies have also varied. While the economies of Australia, Canada, New Zealand, the United Kingdom of Great Britain and Northern Ireland, and the United States of America had been on a course of slow-paced recovery since 1992, the economies of Germany, Japan and most other European countries suffered a serious slow-down or contraction in 1992 and 1993. The 12 countries of the European Union (EU) posted a mere 1.1 per cent average growth in 1992, followed by a negative growth rate of 0.4 per cent in 1993. By mid-1994, however, there were signs of an increasing convergence in growth performance in the industrial economies.

In 1994, the economic recovery in the industrial countries, particularly in Europe, turned out to be much better than was expected at the beginning of the year. All the major industrial countries showed a significant improvement over their recent economic performance, registering an average growth rate of 2.6 per cent compared with 1.2 per cent in 1993. The economies of France, Germany and Italy all recorded positive growth rates of 2.0 per cent or above, in contrast with negative growth rates during the previous year. The economic recovery in Germany was expected to have a strong impact on the overall European recovery. The recovery of the Japanese economy in 1994 was relatively weak, reflected in a modest growth rate of 1.3 per cent, but it appears that Japan is now well poised for much stronger growth in 1995, currently projected at 2.4 per cent. Strong growth is also projected for other industrial countries in 1995, although growth may slow down somewhat

Table I.1. Selected indicators of global economic conditions

(Percentage)

		1990	1991	1992	1993	1994[a]	1995[b]
Economic growth							
World		1.6	0.4	0.7	1.2	2.2	3.0
Major industrial countries – G7[c]		2.5	0.9	1.6	1.2	2.6	2.8
United States		1.2	-0.6	2.3	3.1	3.8	2.8
Germany		4.7	1.2	2.1	-1.2	2.4	3.0
Japan		4.8	4.3	1.1	0.1	1.3	2.4
European Union		2.8	0.8	1.1	-0.4	2.4	3.0
Developing counties		3.0	3.4	4.9	5.1	4.8	5.5
Trade growth							
World trade volume		5.4	5.1	6.0	3.9	7.1	7.0
Developed market economies	Import	4.6	3.0	4.8	1.3	6.2	6.0
	Export	5.1	3.6	4.4	2.5	5.5	6.0
North America	Import	1.4	1.3	10.3	12.2	10.9	7.3
	Export	7.0	6.3	8.1	6.8	7.5	8.5
Western Europe	Import	6.1	3.7	3.3	-3.7	3.7	5.5
	Export	4.2	2.4	3.3	1.3	5.5	5.8
Japan	Import	5.7	4.0	-0.4	2.9	5.8	3.5
	Export	5.3	2.5	1.5	-2.5	1.4	0.8
Developing countries	Import	5.5	12.9	11.5	10.8	11.5	9.0
	Export	8.7	8.5	8.1	7.6	9.0	10.3
Commodities prices and terms of trade							
Non-fuel primary commodities		-7.8	-4.4	-0.1	-3.8	13.6	6.5
Price of petroleum[d]		28.3	-17.0	-0.5	-11.5	-6.0	-
Exports unit value of manufactures		2.2	1.2	1.1	-1.1	1.9	2.5
Terms of trade of developing countries		1.5	-3.0	-	-1.5	-1.7	-0.4
Inflation rates							
CPI[e] in the industrial countries		5.0	4.5	3.3	2.9	2.4	2.6
CPI in the G7 countries		4.8	4.4	3.1	2.8	2.3	2.5
Interest rates							
Nominal libour (six-months)							
on US dollar deposits		8.4	6.1	3.9	3.4	5.0	6.0
on deutsche mark deposits		8.8	9.4	9.4	6.9	5.2	4.8
on Japanese yen deposits		7.8	7.2	4.3	3.0	2.3	2.9
Exchange rate (nominal units per US dollar)							
Yen per US dollar		144.79	134.71	126.65	111.20	103.33	..
Deutsche mark per US dollar		1.62	1.66	1.56	1.65	1.65	..
Financial flows to developing countries (Billions of US dollars)							
Offical flows							
ODA		52.96	56.68	60.80	54.80	..	..
Private flows							
Bonds		7.33	13.87	21.41	55.87	..	..
Loans		24.57	26.11	18.98	20.27	..	..
FDI		31.00	39.00	51.00	80.00	..	..

Sources: International Monetary Fund, *World Economic Outlook* (Washington, DC, October 1994) and *International Financial Statistics*, vol. XLVII, No. 12 (December 1994); United Nations Conference on Trade and Development, *World Investment Report 1994: Transnational Corporations, Employment and the Workplace* (United Nations publication, Sales No.E.94.II.A.14); Department of Economic and Social Information and Policy Analysis, "The world economy at the start of 1995" (December 1994); The World Bank, *Financial Flows and the Developing Countries: A World Bank Quarterly* (August 1994); and national sources.

[a] Figures for economic growth and trade growth in 1994 are preliminary estimates. [b] Forecast. [c] Canada, Japan, France, Germany, Italy, United Kingdom of Great Britain and Northern Ireland and United States of America. [d] Simple average of the prices of several brands of crude oil. [e] Consumer price index.

in some industrial countries where the recovery process had started earlier.

The developing countries' average growth was expected to be lower in 1994, estimated at 4.8 per cent, than the 5.1 per cent growth rate recorded in 1993. This indicated that the recovery in industrial countries had had no immediate or strong impact on the economies of the developing world. An improved growth prospect is, however, foreseen for the African developing countries, partly aided by expected higher demand for and prices of commodities in the industrial countries. Real commodity prices improved significantly through three quarters of 1994, reversing the decline since 1989. While favourable changes in the external economic environment are important in stimulating their economies in the short run, for most developing countries, economic performance and growth in the long run will depend critically on internal conditions such as political stability, and on continuing efforts towards structural adjustment and macroeconomic stability.

The economic experiences in the economies in transition have been varied in 1994, in terms of both growth and progress in their structural adjustment processes. Among the East European economies pursuing "rapid reforms", positive growth rates were recorded in Czech Republic, Hungary, Poland, Slovakia as well as the Baltic States of Estonia and Lithuania. It would appear that the output decline continued in most of the other economies in transition, including the Russian Federation and the Central Asian republics, even though the rate of such decline slowed down in 1994. Overall, the economies in transition are projected to perform significantly better in 1995.

The prospects for the world economy, as a whole, remained optimistic as 1994 came to a close, with world output growth expected to accelerate from 2.2 per cent in 1994 to 3 per cent in 1995. While economic recovery in the industrial countries is expected to give a boost to the developing economies, limited employment gains during the recovery, particularly in Europe where a significant part of the current unemployment is considered to be caused by structural factors, are a matter of concern. Preliminary estimates put the 1994 unemployment rate in the European Union at 11.2 per cent, and the rate is expected to remain over 10 per cent for several more years. It is important that persistent unemployment does not give rise to protective trade barriers to accommodate domestic pressures.

INFLATION, INTEREST AND EXCHANGE RATES

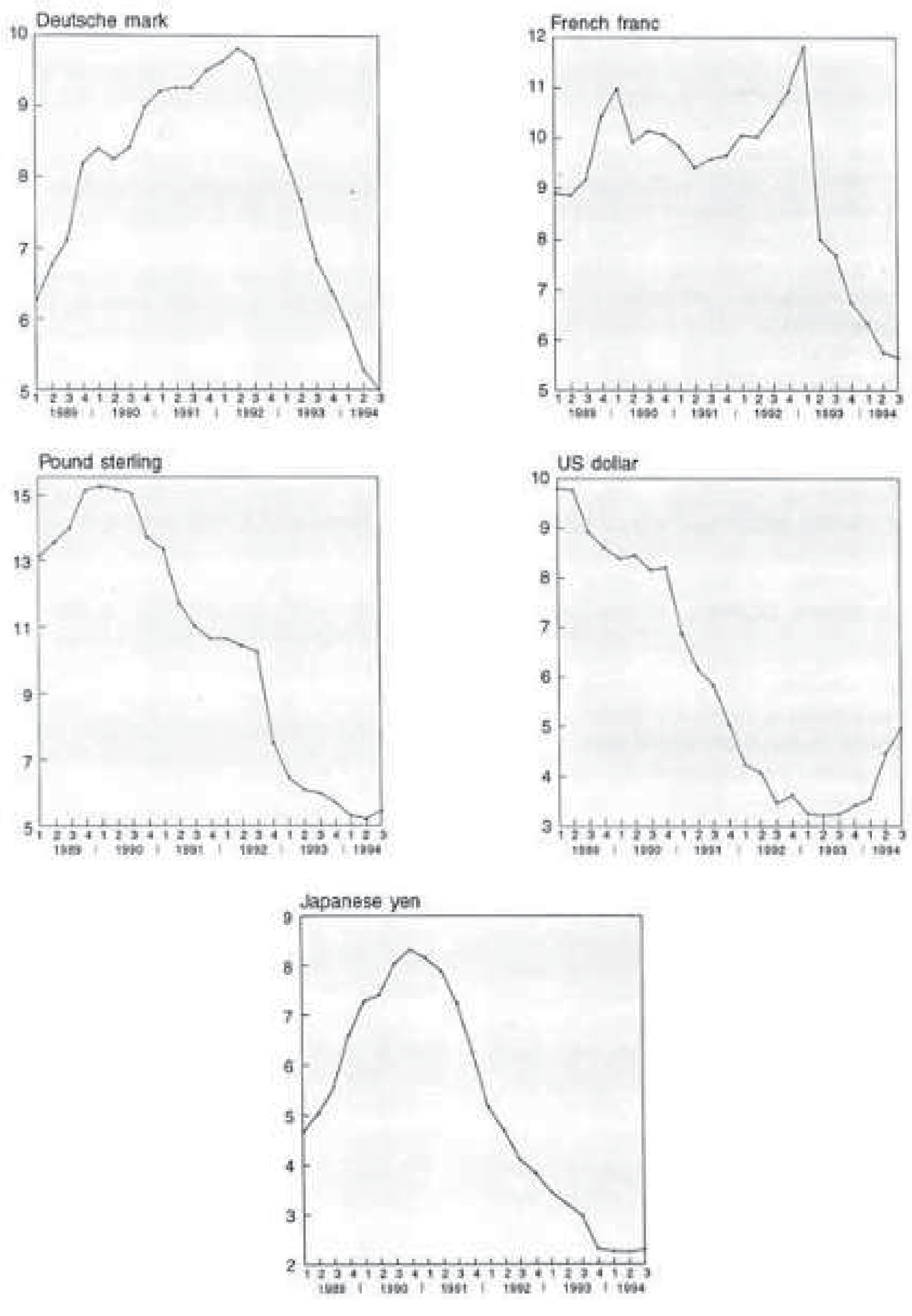
The upward movement of inflation rates to the 5 per cent range in 1989-1990 in most industrial countries from less than 4 per cent since the mid-1980s led to a general tightening of monetary policies. In these economies, macroeconomic stability had been a consistent target of monetary policy since the early 1980s. During the 1980s, the deceleration in inflation was not fully reflected in nominal interest rates and resulted in high real interest rates, a factor that accentuated a number of problems facing the world economy, including that of the debts of the developing countries.

In 1989-1990, when the economies of several major industrial countries were already weakening, the fall in interest rates was halted or reversed with a view to arresting the acceleration of inflation. As these economies weakened further, however, interest rates started coming down in both Japan and the United States, and by 1993 the rates had come down in both countries to their lowest historical levels (figure I.1). The rates in the United States started going up again in early 1994, partly as a result of actions by the Federal Reserve Board to pre-empt any re-emergence of inflation in the wake of recovery. Such pre-emptive actions were justified on the ground that they contributed to the credibility of the anti-inflation policy. The short-term interest rates in the United States were raised six times in 1994 from 3.0 to 5.5 per cent. The actual inflation remained low although the producer price index (PPI) rose by 1.7 per cent in 1994 after a 0.2 per cent advance in 1993. The financial markets' expectation of higher inflation, fed by strong growth and high industrial capacity utilization, was reflected in the sharp increase in long-term bond yields in 1994. In Japan, however, the interest rates continued to fall as the economy's recovery remained weak and inflation was not viewed as a real threat.

Interest rates in Europe took longer to come down and the fall was considered insufficient for an early recovery of the European economies, most of which were in recession in 1992-1993. On the one hand, a high interest policy was used in Germany to deal with the macroeconomic effects of the country's reunification, i.e., the emergence of large budget deficits and the associated fear of inflation. On the other hand, other countries sought to cut interest rates to revive domestic activities. The resulting interest rate differentials set the stage for serious instability in exchange rates in 1992 and

Figure I.1. International interest rates: London interbank three-month offer

(Percentage)



Source: International Monetary Fund, *International Financial Statistics*, vol. XLVIII, No. 1 (Washington, DC, January 1995).

1993 in the European Union and for the decision in August 1993, to widen the permissible band of exchange rates fluctuations from a narrow +/– 2.25 per cent around the official parities to +/– 15.0 per cent. Although German interest rates declined in 1994, the rates remained relatively high, a factor that was seen by many analysts as delaying Europe's economic recovery. However, the faster-than-expected rebound in Europe in the second half of 1994 may have brought the easing of monetary policy to an end. The United Kingdom, for example, announced an interest rates hike, the first since October 1989. To what levels interest rates can be raised safely as a pre-emptive anti-inflationary measure without triggering a recession remains a controversial question in all the industrial countries. This question assumes particular importance in both the United States and Europe in view of stronger political commitments to deficit reduction and the implied limits such commitments place on the use of the budget as a stabilization device. At the same time, a reduction of the massive and mounting budget deficits in the industrial economies is viewed by many as critical to generating increased global savings and hence to low real rates of interest. In this context, the developing countries have a strong interest in the successful resolution of the budgetary problems in the industrial countries.

The major development in the area of exchange rates has been a continued decline in the value of the United States dollar since 1990 (figure I.2), especially against the Japanese yen, but also against most other major European currencies. Part of the depreciation of the dollar against the yen can be explained by Japan's $130 billion trade surplus with the United States which translated into Japanese exporters selling dollars for yen, pushing down the dollar's price, to repatriate their earnings back home. The depreciation could also have been partly policy driven, reflecting the efforts of the United States to improve the international competitiveness of its exports and improve its long running trade and balance-of-payment deficits. However, this policy runs the risk of generating domestic inflation via higher prices for imported goods. The dollar depreciation also reflected in part the long-run shift in the relative strength of the individual economies, as perceived by the international financial markets, and, in part, capital movements in response to differentials in interest rates and returns on various forms of investment.

The continuing depreciation of the United States dollar against most other major currencies, particularly against the Japanese yen, has had implications for the developing world, including the Asia-Pacific region with its increasing openness to the world economy. The effect of changes in bilateral exchange rates among major currencies on individual developing countries varied considerably, depending on how their own bilateral exchange rates *vis-à-vis* the major currencies reacted to such changes. The effect also depended on the relative importance of different currencies in their external trade transactions as well as in debt servicing. While the fall in interest rates served to ease the cost of new borrowings, the changes in exchange rates had an effect on the real value of the proceeds of such borrowings. The magnitude and direction of this effect would, however, depend on the sourcing of goods and services on which such proceeds are spent. The fall in interest rates may also have helped in servicing existing floating interest debts and provided opportunities for debt conversion.

Although the interest rates in different currencies and financial centres had diverged, there were broad agreements in the international policy forums of the industrialized countries, such as the G7 Summit and the Organisation for Economic Co-operation and Development (OECD) Ministerial Council, that monetary policy should remain firmly targeted to provide a stable macroeconomic environment for growth. Policy dialogues among industrial countries, now a regular feature of the conduct of international economic relations, have also brought about a degree of coordination in macroeconomic management with a view to overcoming recession, promoting stable growth, and reducing unemployment. Some of the steps[2] aimed at more balanced and coordinated adjustments among the major economies have included: (a) the efforts of the United States to reduce its long-standing federal budget deficits; (b) the imposition of a uniform ceiling of 3 per cent of GDP on general government deficits agreed upon by the EU countries at Maastricht in 1991; and (c) the introduction of a series of economic stimulus packages in Japan since 1992.

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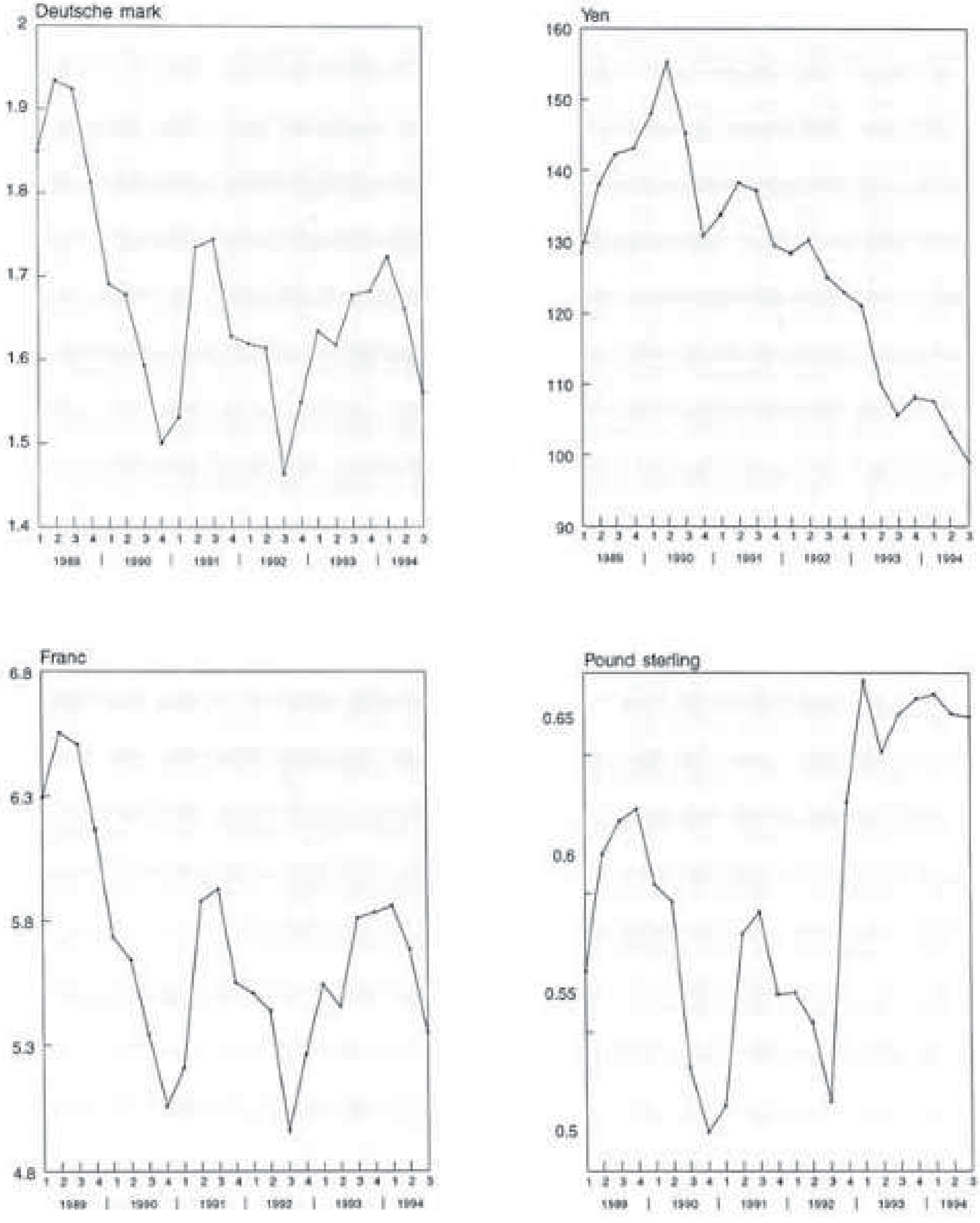
[2] The passing of the United States Omnibus Budget Reconciliation Act in 1993, which put a cap on discretionary budgetary outlays, normally subject to annual appropriation, and froze total normal discretionary outlays at their 1993 level for the following five years, and the introduction of four successive fiscal stimulus packages between August 1992 and February 1994 by the Japanese Government, are some of the examples.

Figure I.2. Exchange rate movements: selected major currencies

(Units per US dollar)



Source: International Monetary Fund, *International Financial Statistics*, vol. XLVIII, No. 1 (Washington, DC, January 1995).

INTERNATIONAL TRADE AND BALANCE OF PAYMENTS

In 1993, the rate of growth in the volume of world trade was one of the lowest in recent years. After increasing from 5.1 per cent in 1991 to 6.0 per cent in 1992, the rate of growth declined sharply to 3.9 per cent in 1993. That reflected the slow movement of both exports and imports of several major industrial countries. Of special significance to the rest of the world economy was the severe slowing down of imports in the developed market economies, with imports growing by a mere 1.3 per cent in 1993, compared with 4.8 per cent in 1992. Had there not been an impressive average of 12.2 per cent growth in North American imports, the overall slow-down would have been even more severe. The imports of Western Europe registered an overall negative growth of 3.7 per cent, although the United Kingdom had a positive growth rate (4.2 per cent), reflecting the earlier onset of its recovery. There was a strong contraction of imports in Germany (12.9 per cent), France (10.4 per cent) and Italy (7.7 per cent). Japan's imports rose by 2.9 per cent, while those of Canada increased by 10.3 per cent.

In 1994, the preliminary estimate of growth in the world trade volume was put at 7.1 per cent, nearly twice the rate recorded in 1993. The exports of the developed market economies grew at 5.5 per cent, compared with 2.5 per cent in 1993. Their imports were estimated to have risen by 6.2 per cent with positive growth in all industrial countries, thereby sharply reversing the slow-down or fall in 1993. Import growth, however, weakened in the United States and Canada and remained very modest in most European countries, as reflected in a mere 3.7 per cent growth in West Europe. Based on preliminary estimates, it was expected that Japan's imports would accelerate to a 5.8 per cent growth in 1994. This represented a doubling of Japan's imports from the 1993 level.

The developing countries (including the eastern European countries and the former Soviet Union) accounted for approximately one third of world trade. Their export and import volumes (excluding those of eastern Europe and the former Soviet Union) rose by 7.6 and 10.8 per cent respectively in 1993 in sharp contrast with those of the industrial countries. The Asian economies, excluding West Asia, accounting for approximately 15 per cent of world trade, led in trade growth, as it did in output growth, with almost a 10 per cent growth in exports and more than 11 per cent in imports. In 1994, the trade growth of the developing countries remained high, with estimated growth rates of 9.0 per cent for exports and 11.5 per cent for imports. Export growth will be helped by the world economic recovery and a revival of imports of industrial countries.

The continuing fall in commodity prices in recent years has tended to keep the value of export earnings of the developing countries depressed. Non-fuel commodity prices fell continuously from 1989 to 1993, as did fuel prices from 1991 to 1993 after the brief rise during the height of the Persian Gulf crisis. Fuel prices fell by an average of 11.5 per cent and the non-fuel commodity price index by almost 4 per cent in 1993. Although the prices of manufactures also fell, the terms of trade of developing countries deteriorated by 1.5 per cent, resulting from a terms-of-trade decline of 3.6 per cent for fuel exporters and 1.2 per cent for non-fuel exporters. Asian economies, with their more diversified export base and relatively large share of manufactures in exports, suffered the least in terms-of-trade losses: a fall of 0.7 per cent compared with 1.9 per cent for Latin America and 3.5 per cent for Sub-Saharan Africa. Moreover, the loss for the Asian economies came after positive gains of 1 and 2 per cent respectively in 1991 and 1992 whereas for Latin America and Africa there has been an uninterrupted sequence of losses since 1986.

In 1994, the terms of trade were estimated to decline again by another 1.7 per cent for all developing countries. There was also a change in the pattern of decline for different country groups. The fall for Latin America was limited to 0.9 per cent, but for Sub-Saharan Africa the terms of trade improved, for the first time since 1986, by 4 per cent. The developing countries in Asia experienced a decline of 0.6 per cent.

Between the fourth quarter of 1993 and the third quarter of 1994, the overall index of real commodity prices of export commodities of the developing countries increased from 71 to 85 (1985=100). This increase in commodity prices resulted in part from the economic recovery and the associated revival of demand in Europe and Japan and partly from supply shortages. Sustainability of fair commodity prices is a continuing issue of critical importance to many developing countries. Indeed, commodity prices continued to decline during the 1987-1989 boom in world economic growth, indicating that commodity price movements depend on a host of factors, some of them cyclical while others are structural. Therefore, the expectation that the economic recovery of the advanced economies will by itself significantly raise commodity prices on a sustainable basis may turn out to be unrealistic.[3] While the pace of economic recovery is expected to pick up in Europe and Japan, the two largest importers of commodities, that in the United Kingdom and the United States may slow down, suggesting that the overall demand may very well be less than robust.

To the extent that the price increase in 1994 could be attributed to supply shortages caused by exogenous factors, such as the effect of adverse weather on some agricultural supplies, the increase in commodity prices may well be short-lived. If the recently concluded Uruguay Round leads to a cut-back in agricultural production in high income economies, particularly in Europe, through the reduction or elimination of agricultural protection, a boost in agricultural prices could be expected, although the extent of such increase is uncertain.[4] Oil prices are not expected to rise despite world economic recovery, as excess supply is likely to continue.

The asymmetry in the trade and balance of payments among major industrialized countries has remained a source of trade tension and protectionist pressure in the world economy. No solution for this long-standing issue appears to be in sight. A further rise in the United States deficits and Japan's surpluses in 1993 and 1994 pointed to the continued difficulties in that area. The European economies, remaining in recession with depressed levels of imports, turned their $43 billion deficit in 1992 to a surplus of $12 billion in 1993. The surplus, however, was unlikely to be sustained as economic recovery picked up strength in Europe. The developing countries recorded an increase in their overall deficits from $67 billion in 1992 to $104.6 billion in 1993 and $106.2 billion in 1994, owing to a strong surge in imports as noted earlier. The Asian developing countries experienced the sharpest increase in deficits from $2.7 billion in 1992 to $24.6 billion in 1993. Latin America and West Asia also registered large increases in deficits in 1993. In 1994, the overall trade deficit of the Asian countries was estimated to be $22 billion.

Both macroeconomic and trade and exchange rate policies have been deployed to reduce the persistent trade imbalances among the major economies of Europe, Japan and the United States. Efforts to stimulate demand and imports in surplus countries, by using the monetary and fiscal instruments in a more concerted manner, have not proved effective thus far. The exchange rate adjustment has not been any more effective either in correcting the trade imbalances; despite the steep depreciation of the United States dollar *vis-à-vis* the Japanese yen, which makes Japan's exports to the United States more expensive and the United States' exports to Japan cheaper, the huge bilateral trade surplus of Japan with the United States has persisted.

This lack of success in macroeconomic and exchange rate policies has led to a tendency to use bilateral trade policies to solve the problem of persistent trade imbalances. In such cases, the deficit country demands market access from the surplus country, sometimes on pain of unilateral retaliatory action, and negotiates specific market-opening measures to be adopted by the deficit country. The possibility of adopting this kind of trade policy action has occasionally been indicated against some of the developing countries with bilateral surpluses.

However, the fact remains that the developing countries in all regions, notably in Asia, have been increasing their imports faster than exports, thereby incurring growing deficits in their own global trade and payment balances. Yet, exports of developing countries face restrictions in many developed countries on a variety of grounds. The imposition of countervailing duties on videotapes, computer disks and television sets exported to the European Union from a number of Asian countries in 1994 is a case in point. Developing countries have also faced a variety of non-tariff barriers in the industrial countries. The index of coverage of imports affected by non-tariff barriers in those countries increased by 3.1 per cent between 1980 and 1990.[5]

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[3] During the period 1980-1993, real commodity prices more than halved, three fourths of the fall being attributable to the fall in agricultural prices. Larger agricultural supply, and not a decline in demand, is considered to be the major reason for the decline in agricultural prices. Interestingly, 75 per cent of the incremental supply that pushed prices down came from high income countries.

[4] During the Uruguay Round of multilateral trade negotiations, net food-importing countries expressed concerns over the potentially adverse implications of a rise in food prices following the liberalization of world agricultural trade.

[5] Heinz G. Preusse, "Regional integration in the nineties: Stimulation or threat to the multilateral trading system?", *Journal of World Trade*, vol. 28, No. 4 (August 1994).

Box I.1. The General Agreement on Trade in Services: an overview

The General Agreement on Trade in Services (GATS) negotiated under the Uruguay Round is an important new development in world trade in that it has brought trade in services within multilateral discipline for the first time. Issues in trade in services were negotiated in parallel with, but separate from, those on trade in goods. This "twin-track" approach reflected concerns that if negotiations on goods and services were linked, progress in some vital areas of trade, such as in agriculture and textiles, might slow down or even stall because of difficulties in the "new" negotiating area of services.

The delinking of the negotiations on trade in goods and on services also underscores the presence of some important differences between them. First, unlike goods, most services are intangible and non-storable, implying a close proximity in time and place of their production and consumption and thus requiring a movement of either the consumer (as in tourism) or of the provider.[a] When the provider moves either temporarily (for example, for a construction project) or to establish a commercial presence in the host country (for example, to open an accounting firm) to deliver the services, factors of production also move across national boundaries. For the efficient delivery of services such factor movement often becomes essential. Second, unlike tariffs on goods, there are no equivalent quantifiable barriers to trade in services: the barriers to trade in services are embedded in a host of domestic laws, regulations and other measures relating to conditions, such as for investment and competition, movement of service-related personnel, and access to foreign exchange and infrastructural facilities. Liberalization of trade in services involves effecting changes in these laws, regulations and other measures.[b]

The agreements reached under GATS contain two kinds of obligations: the general obligations that apply to all services included in the agreement, and the obligations created by specific commitments made by signatories on particular services and modes of supply.[c] The major general obligation relates to the most favoured nation (MFN) principle – that a signatory treat all countries in a manner no less favourable than their treatment of a particular country. However, GATS allows exemptions from MFN under conditions specified in an annex to the agreement. Such exemptions have a normal limitation of 10 years on their duration. In fact, a large number of countries, including the United States of America, have sought such exemptions with respect to at least some important service industries. Other general obligations relate, *inter alia*, to transparency of domestic laws and regulations affecting trade in services, mutual recognition and harmonization of regulatory standards (for example, educational requirements in professions), and to the increased participation of developing countries in world trade in services. A novel feature of GATS has been its integration of development concerns through explicit provisions on developing country access to technology and to information and distribution channels and networks; liberalization of market access in sectors and modes of supply of export interest to these countries is also provided.

The coverage of GATS includes virtually all existing service industries,[d] with only a few exemptions that include the services supplied in the exercise of governmental functions, although this exemption does not apply to services provided by a government on a commercial basis or in competition with one or more service suppliers. Recognizing the diversity of services covered by it, GATS addresses, through a number of annexes, the special situations of individual services sectors and provides for sector-specific commitments. For example, the annex on air transport excludes landing rights but provides for the coverage of airline computer reservation systems, marketing of aviation services and aircraft repair and maintenance. Specific commitments of a signatory

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[a] In some cases, of course, no such movement is necessary. An example of such "cross-border supply" is the provision of an architectural design via fax.

[b] Many countries regard such changes as an infringement on their right to control and protect specific services industries according to their own developmental, social and cultural priorities. This partly explains the initial reluctance of many developing countries to include services in multilateral trade talks. This reluctance also reflected their concern that the dominant position of the developed countries in the world services trade would rule out any reasonable "balance of concessions" in the course of the negotiations.

[c] GATS deals with three modes of supply: those involving no movement of providers or consumers, those involving movement of providers only, and those involving movement of consumers only. A particular service may be supplied in more than one mode. A signatory to GATS can choose the mode or modes to be included in its liberalization commitments.

[d] These services numbering more than 150 were classified by the GATT Secretariat into 12 broad categories: business, communications, constructions, distribution, educational, environmental, financial, health-related and social, tourism and travel-related, transport and "other" services.

are contained in a national schedule. GATS uses a "positive list" approach, that is, unless a specific services industry is scheduled, no commitment is being made with respect to it.[e]

It is largely through market access and national treatment commitments of the signatories that the actual liberalization under GATS will be achieved. However, market access, i.e., freedom of entry and exit, and national treatment, i.e., non-discrimination between domestic and foreign service providers, are not automatically provided under GATS, but are to be exchanged as negotiated commitments, distinguished by sectors or subsectors and modes of supply. So far, most liberalizing offers have been made in the areas of travel and tourism services, and financial and business services; the sectors with low coverage include education and health services.

As many developing countries have a comparative advantage in labour-intensive services industries, they have a special interest in the movement of labour. They have argued that movement of labour to facilitate delivery of services should be given the same treatment as the movement of capital for that purpose. It should be noted in this context that GATS provisions relate to the temporary movement of labour for the delivery of services and not to permanent migration. There have been extensive offers on entry and temporary stay of natural persons, although most offers cover skilled intra-corporate transferees. A negotiating group is currently working on ways to achieve higher levels of commitments in this area.

In terms of overall industry coverage, the Organisation for Economic Co-operation and Development (OECD) countries have made some kind of commitment for more than 50 per cent of service activities, as compared with 15 per cent for developing countries. These numbers are clearly provisional, and are likely to change as negotiations proceed. The complex structure of GATS, the non-transparency of barriers to trade in services and the fact that negotiations are still in progress on some important areas such as financial services, basic telecommunications and the movement of natural persons, make it very difficult to evaluate the liberalizing impact of GATS at this early stage. The developing countries are still engaged in seeking a fuller understanding of the issues in services trade and the implications of liberalization of this new, complex arena for their own development goals. The trade liberalizing effect of many developed country commitments will also be limited by the exemptions from MFN sought by many of them. In the longer run perspective, however, GATS potentially provides a much-needed framework for continuing negotiations aimed at a progressive liberalization of trade in services.

[e] This is different from the negative list approach where all existing or potential industries are presumed to be covered, unless explicitly excluded. The North American Free Trade Agreement used this approach.

The conclusion of the Uruguay Round, with a broad range of agreements signed in April 1994 and awaiting phased implementation from 1995 after ratification by signatory countries, has been regarded as an event of great significance for the future pattern and growth of international trade in both goods and services. The agreement brought international trade in services under multilateral rules for the first time under a General Agreement on Trade in Services (GATS) (see box I.1). New agreements covering various aspects of trade in goods have also been reached. Under the new agreements, non-tariff barriers in agriculture, a persistent source of trade tensions between the developing and the developed countries, will be converted to their tariff equivalents though a "tariffication" process and the resulting overall tariff will be substantially reduced in phases and bound by a large number of developed and developing countries. Tariff reductions will also apply to manufactures. A very active participation in the negotiations by the developing countries gave the Uruguay Round a degree of universalism not achieved in the seven previous GATT (General Agreement on Tariffs and Trade) rounds of multilateral trade negotiations. Sectors of trade, such as agriculture, and textiles and clothing, which were virtually excluded from the GATT discipline, will be integrated into the multilateral framework in a phased manner. All voluntary export restrictions (VERs) will also be terminated. The establishment of the World Trade Organization will provide a strengthened institutional mechanism for administering multilateral trade rules, for settling trade disputes, for conducting future multilateral trade negotiations and for promoting mutually beneficial trade relations among countries. All in all, the agreement was widely expected to give new impetus to world trade in both goods and services. Estimates of a 10 per cent boost in world trade and a $250 billion rise in world income annually as a result of efficiency gains have been reported.[6]

[6] International Monetary Fund, *World Economic Outlook*, May 1994 (Washington, DC, 1994), p. 1.

The gains, however, will materialize only gradually as the implementation of the main elements of the agreement will be phased over varying periods of time. The transitional period will not be easy for many developing countries as they will need to make considerable adjustments in their policy regimes to meet their obligations under the terms of the new agreements on goods and services, and to prepare themselves to meet the competitive challenge that promises both risks and opportunities in the world marketplace.

Meanwhile the trend towards regionalization of world trade, investment and economic activities continues unabated and, in many cases, has intensified. The completion of a single European market to bring about a closer integration of most European economies within an expanded European Union, and the coming into force of

Box I.2. Regionalization and multilateralism in world trade

There has been a pronounced acceleration over the past few years in the trend towards formal regional trade arrangements in different regions of the world. The completion of the Single European Market, the coming into effect of the US-Canadian Free Trade Agreement and its later expansion into the North American Free Trade Agreement (NAFTA), the projected completion of the ASEAN Free Trade Area (AFTA) by 2003, the recent launching of the Mercado Comun del Cono Sur (MERCOSUR) involving four South American countries, the declaration by Asia-Pacific Economic Cooperation (APEC)[a] to achieve free trade and investment in Asia and Pacific by 2020 and the pledge at the summit of the Americas to establish a free trade zone encompassing 34 economies in the Western hemisphere provide some examples of this trend. In some of these cases, a significant proportion of the total trade of the countries involved is conducted within these regional formations. For example, intraregional trade constitutes 70 per cent of the total trade of members of the European Union (EU), while United States-Canada trade before NAFTA came into force constituted 30 per cent of the two countries' total trade. Thus, a progressively larger proportion of world trade may become internalized within regional arrangements as more of them become firmly established.

However, the successful conclusion of the Uruguay Round has given a fresh stimulus to the cause of multilateralism in world trade. Although the full implications of the new trade order emerging out of the Uruguay Round are not yet known, it is generally agreed that international trade will receive a quantum boost with full implementation of agreements on bringing agriculture, textiles and services under multilateral discipline; on reduction of tariffs and elimination of non-tariff barriers; and on the strengthening of the mechanism for the settlement of disputes.

[a] APEC comprises Australia, Brunei Darussalam, Canada, Chile, China, Hong Kong, Indonesia, Japan, Malaysia, Mexico, New Zealand, Papua New Guinea, Philippines, Singapore, the Republic of Korea, Taiwan Province of China, Thailand and United States of America.

The world trading environment is thus being shaped by the simultaneous operation of the forces of regionalization and multi-lateralism. A pertinent question that arises is – are the two forces compatible? It can be argued that the regional arrangements in a large measure reflect and accommodate some fundamental changes in recent times that have given both production and trade a globalized character. Since about the mid-1980s barriers to trade, foreign direct investment and financial flows have been progressively dismantled by practically all countries, both developing and developed. At the same time there have been technological changes which permit the location of different links in the value added chain in different countries as well as the rapid transfer of investment finance around the globe. All these changes, supported by major improvements in transport and communications, have allowed and encouraged the international division of labour to be carried to new limits, often involving the breakdown of production into sub-activities spread across national boundaries. Trade, investment and service flows have become increasingly complementary to one another. These broader dimensions of interaction among economies are frequently referred to as "globalization".

The process of globalization has also served to internationalize issues that traditionally used to be areas of domestic policy concerns. Such issues as labour, technology, competition and the environment are now having trade implications. Therefore, it is not trade policy alone but the whole range of economic and even social policies which require greater coordination and harmonization among trade partners. It is contended that a regional arrangement provides a more viable framework than a multilateral one for the often sensitive task of rationalizing and harmonizing a wide range of domestic policies.[b]

Furthermore, the increased competition and the efficiency gains through economies of scale in the larger

[b] For example, the coverage and depth of issues dealt with in NAFTA are not likely to be achievable, at least as yet, through a multilateral forum.

the North American Free Trade Area Agreement (NAFTA) are two major examples of this regionalization process. There are other initiatives involving developing countries in many parts of the world, although the progress and achievement of these have remained limited. There are proposals for free trade among groups of developing and developed countries under the auspices of APEC (Asia-Pacific Economic Cooperation). Although NAFTA, comprising Canada, Mexico and the United States, included countries at substantially different levels of economic development as well, the APEC initiative would represent an experiment on a much grander scale in terms of the number of countries involved and the diversity among them. A similar initiative is also under way involving the countries in North America, Latin America and the Carribean. The implications of such growing regionalization for the multilateral framework of trade need to be carefully assessed (see box I.2).

market-place that regional arrangements provide are expected to increase income and export capacity, creating pressures for extraregional trade and hence for increasing openness. Therefore, these trade arrangements should not be viewed as inherently inward-looking but rather as a "second-best" approach to dealing with an increasingly complex world trade order in the absence of the "first-best" scenario, namely, a completely liberalized world trade order with transparent and enforceable "rules of the game". By exposing the participating countries to greater competition, by helping to dismantle trade-restricting domestic policy regimes, and perhaps by adopting common negotiating positions to promote liberalization in trade negotiations, these regional arrangements have the potential, so it is argued, to serve as building blocks of a truly liberalized multilateral trade order.

Scepticism over the above possibilities being realized stems largely from the fear that these regional arrangements have a tendency to turn inward and protectionist as they evolve. Such protectionism, rather than higher productivity of capital, may draw investment away from countries excluded from a regional arrangement. As countries at lower levels of economic development are not quite in a position to join an arrangement on a fully reciprocal basis, there is often a reluctance to admit them.

In light of the above arguments, it is difficult to conclude a priori regarding the compatibility of regionalization with multilateralism. The critical issue relates to how regional arrangements are conceived and implemented. As long as they adopt an open-door policy to new members, continue with liberalization based on the most favoured nation principle, adopt liberal rules of origin, strengthen anti-dumping discipline, they could very well serve as building blocks for a more liberalized world trade order. "The compatibility of regionalism and multilateralism is not a matter of principles, but of behaviours."[c]

[c] Enzo Grilli, "Regionalism and multilateralism: conflict or coexistence?", *Development and International Cooperation*, vol. IX, No. 17 (December 1993), p. 59.

INTERNATIONAL CAPITAL FLOWS

Two important features of international capital flows to the developing countries in recent years have been the growing importance of private sources and an increasing importance of non-bank sources within the category of private international capital. This category includes a number of channels: financial flows comprising bank loans, bonds and equities, and FDI. The volume, composition and the direction of these international capital flows have undergone important changes in recent years.

In the 1990s, liberal market reforms involving both the real and financial sectors of economies worldwide, an improvement of the debt problems of the developing countries, and a more active involvement of the former centrally planned economies in the world market-place, have all provided impetus to a spurt in international private capital flows. Total private financial capital flows worldwide almost doubled from $434.9 billion in 1990 to $818.6 billion in 1993. Although international bank lending has revived since the debt crisis receded, the largest share of capital has been raised through the issue of bonds. Of the total raised in 1993, more than one half was against bond issues and about 17 per cent in bank loans. Bonds and syndicated bank loans together accounted for 75 per cent of the total flow. The rest were against commercial papers, notably Eurocommercial papers and note-issuing facilities. A smaller but growing proportion (about 5 per cent in 1993 as against 1.7 per cent in 1990) of the flows were in equity capital.

The developing countries received 11.2 per cent of the total flow in 1993 as against 7.6 per cent in 1990. They received 83 per cent of their total from bond issues and bank loans, a higher proportion than the 75 per cent share of the two categories in the global flows. The share of the developing countries in total bond issues and bank loans was thus higher at 12.3 per cent than their share in the total flow at 11.2 per cent in 1993. These figures indicated that the share of equity capital in the total flow for the developing countries was less than the world average, despite a rapid increase in such inflows to some developing countries in recent years. As the capital markets in the developing countries develop and mature, the equity capital flows may be expected to increase further in the future. This carries the implication that the developing countries will have to contend with the problem of speculative capital flows that are now a regular feature of the highly integrated and globalized international financial markets.

The FDI component of capital flows slowed considerably in 1991 and 1992, total global flows declining from $208 billion in 1990 to $158 billion in 1992, but increasing to $194 billion in 1993. This slow-down reflected a decline of inflow to the developed countries, principally from Japan. The recession affecting the investible surplus available to Japanese enterprises, combined with the recession-induced weak demand in the host countries, caused Japanese investment in the United States and Europe to decline. The developing countries, however, continued to increase their absorption of FDI with a sharper acceleration in recent years. Thus, the inflows to the developing countries increased from $51 billion in 1992 to $80 billion in 1993. The level of inflows reached in 1993 was almost three times that of 1990. That raised the share of the developing countries in total FDI flows to more than 40 per cent, and the share in incremental FDI flow to 80 per cent in 1993, making FDI the largest single component of net resource flows. It should be noted that outflows from developing countries also increased to $14 billion in 1993 from $10 billion in 1990. The developing countries were thus emerging rapidly not only as recipients but also as contributors to global FDI flows.

In 1994, the external environment turned somewhat less favourable for private external capital inflows to the developing countries as the broadening recovery in the industrial countries led to rise in both short-term and long-term interest rates in the United States and some other home countries causing some portfolios to return to domestic markets. However, the impact on the developing countries was not significant with Latin America suffering a reduction in bonds, equities and, in particular, bank loans. In contrast, flows of equities and bonds to Asia were stable while the flow of bank loans significantly increased. Overall, in 1994, the share of the developing countries in the global flow of bonds went down by 4 per cent and those in equity and bank loans went up by 5 and 8 per cent respectively.[7]

The trend towards an increased flow of private capital to the developing countries has been influenced by both demand and supply factors. On the supply side, the search for higher returns than available in industrial-country capital markets coupled with the desire of institutional investors to spread their country risks has been a major factor in increasing outflows from developed countries. On the recipient side, the demand for capital came principally from two sources, namely, to augment reserves and to meet current account balance-of-payment deficits arising from fast expanding domestic consumption and investment demand. The process of capital transfer was aided by the liberalization measures in both financial and real sectors in the developing countries. While a sizeable part of the inflows in the late 1980s went to augment reserves in many developing countries with their current accounts in the balance of payments showing increasing strength, more recent flows have reflected a worsening of current account balances since 1990. Rising investment and consumer demand, buttressed by strong economic growth, caused external payment deficits and the financing needs to widen. Most recipients have experienced a spurt in domestic investment as privatization, deregulation and other investment liberalization measures were implemented. Foreign direct investment was financing an increasing proportion of the large investment being undertaken for the development and renewal of infrastructure in many developing countries. This reflected an important new trend marking a departure from the traditional policy of undertaking infrastructural investment activities in the public sector in many countries. The emerging capital markets of many developing countries have also become more liberal and receptive of foreign equity flows.

One significant fact about the private capital flow to the developing countries is its concentration in a limited number of the middle-income countries, particularly in Latin America and in East and South-East Asia. Thus, Latin America, East Asia and South-East Asia received almost 75 per cent of all

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7 Guillermo de la Dehesa, *The Recent Surge in Private Capital Flows to Developing Countries: Is It Sustainable?*, 1994 Per Jacobsson Lecture, Per Jacobsson Foundation (International Monetary Fund, Washington, DC, 1994).

private capital flows to developing countries during the period 1991-1993. Argentina, Brazil and Mexico accounted for more than 80 per cent of the flows to Latin America in that period: in East Asia and South-East Asia, China, Indonesia, Malaysia, the Republic of Korea and Thailand accounted for 90 per cent of the flows received.[8] Private capital flows to low-income countries, however, increased only marginally from $15.0 billion in 1989 to $16.6 billion in 1993. The share of the least developed countries in the total FDI inflows to developing countries was less than 1 per cent, falling from an average of 2.1 per cent during the period 1986-1990.

The recent decline in the volume of official development finance to the developing countries reflected the growing emphasis on private capital flows and a weakening commitment on the part of aid donors. Official development assistance (ODA) from the Development Assistance Committee (DAC) of OECD countries and multilateral institutions fell by 10 per cent to $54.8 billion in 1993 from $60.8 billion in 1992. The decline reflected a smaller bilateral flow as well as reduced contributions to multilateral agencies. These are attributable to moves by several donor countries to cut aid budgets. The average share of GNP devoted to aid by the DAC countries fell to 0.29 per cent, the lowest since 1973 and far short of the internationally recognized target of 0.70 per cent. One positive aspect of the story was that some relatively small donor countries, such as Denmark and Norway, continued to register shares of more than 1 per cent of their GNP in aid contributions. Multilateral lending was similarly on the decline.

Another factor that contributed to the slow growth or decline in ODA flows to developing countries was the competing demand on international resources created by such developments as the increased cost of peace-keeping operations of the United Nations from less than $300 million in 1988 to over $3.6 billion in 1993, and the assistance, provided by OECD countries to eastern and central European countries, which grew from almost zero before the end of the cold war to $7.5 billion in 1992. A growing proportion of the available aid resources has also gone to the provision of distress relief in the wake of natural disasters and the exodus of refugees in many parts of the world, contributing further to the decline in funding for long-term development.

This flagging international support for development assistance comes amidst evidence of chronic poverty in the world, mounting population pressures, widespread environmental deterioration, and an increasing gap in the living standards between the world's rich and poor. Moreover, the decline in ODA is of particular concern to the least developed and other disadvantaged economies. These economies suffer from a variety of structural limitations that constrain their ability to attract private capital, making the availability of ODA all the more critical for them.

At the same time, there are some concerns regarding the sustainability of private capital inflows to developing countries. With the strengthening of economic recovery in the industrial countries, the demand for capital is expected to increase in those countries. This may reduce the availability of private capital for developing countries. Besides, the upward pressure on long-term market interest rates, resulting from policy measures to prevent inflation and to choke off excess demand for capital in industrialized countries, may increase the costs of borrowing to the developing countries.

Prospects for an increased access to the resources of multilateral organizations are not promising either. In fact, net lending (i.e., new lending minus repayments of principal) of the International Monetary Fund (IMF) to the developing countries has remained negative since 1986 with the exception of 1991. In 1993 this negative net flow amounted to $400 million. Efforts to provide increased access to development finance by creating new international liquidity through the IMF Special Drawing Rights (SDRs) mechanism have not yet made much headway because of lack of agreement, either on the size of the SDRs allocation or on the criteria to be used in the distribution of these resources among the member countries. A similar reduction in development finance channelled through the World Bank/International Development Association (IDA) as well as bilateral ODA flows has taken place recently as noted earlier. In fact, the net transfer to developing countries through the World Bank/IDA channels also turned negative in 1991 and remained so in 1992 and 1993, although the net transfer to the most needy regions, in particular sub-Saharan Africa and parts of Asia, remained positive. The problem of mobilizing development finance is further compounded by deteriorating terms of trade

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8 World Bank, *Financial Flows and the Developing Countries: A World Bank Quarterly* (August 1994), p. 21.

that have limited developing countries' capacity to generate real resources for development through their own export earnings. It is estimated that the 1993 trade activities of developing countries would have generated an additional $75 billion, if they had received and paid export and import prices prevailing in 1989. Even with an increasing diversification in export structures, countries in South and East Asia suffered a terms-of-trade loss equivalent to 1.6 per cent of GDP over the period 1990-1993.[9]

CONCLUDING OBSERVATIONS

The rates of growth of GDP, exports and imports of developing countries have been, on average, faster than those of the industrial countries and above the world average in recent years. In the developing world, the developing countries of the ESCAP region have led the way in terms of income growth in recent years and the pattern is expected to continue in 1995. The average growth in these countries is expected to be 7.5 per cent in 1995, as compared with 5.5 per cent for the developing countries as a group and 2.6 per cent for the major industrial countries.

While the trade and investment interface of the developing countries of the ESCAP region with the rest of the world economy continues to be a major source of their economic growth, this growth is being led increasingly by growth in domestic demand and a brisk expansion in intraregional trade and investment flows. These countries are also emerging as substantial contributors to the world capital flows as evident from the large increase in FDI outflows from them in 1993. These intraregional linkages, however, remain largely concentrated in a limited number of countries in the region. In a regional context, an important policy issue, therefore, concerns finding ways to bring the rest of the developing countries into this "virtuous circle" of intraregional trade and investment flows.

As noted before, the growth in such intraregional linkages explains in large measure the resilience shown by the developing economies of the region to the weakness of economic activity in industrial countries in recent years. In fact, the continuing growth in developing countries, especially those in the ESCAP region, and the associated increase in their demand for developed country exports at a time when the trade among the developed countries stagnated, were important reasons why recession in the developed economies did not turn into a global recession.

The economies of the developed and developing countries have thus become intricably linked in an increasingly globalized world economy. It is, therefore, essential that international economic policy-making should take full account of the rising interactions among groups of countries. The effort to secure a wider participation by developing countries in the Uruguay Round of multilateral trade negotiations reflected a move in that direction. However, policy-making and management structures of some international institutions continue to reflect the historical strength of economies of the world at the time of their inceptions. The question of giving a greater role to developing countries in global economic governance deserves serious consideration by the policy makers in the international arena.

9 United Nations, "Macroeconomic policy questions: net transfer of resources between developing and developed countries" (A/49/309).

II. MACROECONOMIC PERFORMANCE AND POLICIES

RECENT PERFORMANCE AND SHORT-TERM PROSPECTS: AN OVERVIEW

The developing countries of the ESCAP region continued their robust performance in the past year. Their combined gross domestic product (GDP) growth rate is estimated at 7.7 per cent compared with 7.2 per cent recorded in 1993. The prospects of these countries in the years 1995 and 1996 remain bright with projected growth rates of 7.5 and 7.0 per cent respectively (table II.1). As in the past, the average growth performance of the developing countries of the region in 1994 far exceeded that of the world which was estimated at 2.2 per cent.[1] This will continue to hold in 1995 and 1996, although the differentials will narrow as the estimated world growth rate is expected to increase to 3.0 and 3.4 per cent respectively.

As regards developed countries, Australia and New Zealand recorded growth rates of the order of 4 per cent in 1993-1994. They are expected to achieve comparable rates in the next two years. In Japan, the recovery which appeared to have become firmer by the end of 1994 is expected to gain further strength in 1995 and 1996.

Several factors support the optimistic growth projections for developing countries in the region in the next two years. The momentum of policy reforms with a strong emphasis on deregulation, liberalization and outward orientation will be maintained or accelerated throughout the region. This will provide a congenial environment for sustained increases in domestic saving and investment. Higher production capacity thus created will be effectively complemented by strong growth in domestic demand for higher quality goods and services by a growing middle class. Intraregional trade and investment are likely to maintain their upward trend in response to emerging changes in comparative advantage. This will be supported by an intensification of regional cooperation articulated through various regional and subregional cooperation arrangements. The conclusion of the Uruguay Round of multilateral trade negotiations will create new opportunities for export expansion. With continued policy reforms and rising domestic demand, the region will continue to attract a significant share of global foreign investment inflows. While these factors lend credence to high growth projections for the region in the short term, it should be emphasized that the long-run performance will depend on productivity improvements (see box II.1).

This impressive growth performance of the developing countries in 1994 was achieved with an estimated inflation rate of 9.9 per cent. Macroeconomic stability is widely acclaimed as the hallmark of the development strategy pursued in the Asia-Pacific region. It is, therefore, somewhat disconcerting that the past year saw a significant increase in the inflation rate from 7.3 per cent in 1993. Although the principal explanation lies in the dramatic upsurge of inflation in China from 13 per cent in 1993 to 21 per cent in 1994, a number of other countries also experienced a substantial increase in inflation with double-digit rates being recorded in India, Pakistan, Sri Lanka and Viet Nam. If China were excluded, the average inflation rate of the developing countries in the region would be 6.3 per cent in 1994, one percentage point higher than in 1993.

Whereas the developing countries of the region as a group recorded an improved growth performance in 1994, there have been significant differences among individual countries and among subgroups. It is, however, noteworthy that the mild trend towards a narrowed differential between subgroups has continued. Thus, while the average growth rate of both East and South-East Asian

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[1] United Nations, "The world economy at the start of 1995" (22 December 1994).

Table II.1. **Forecasts of growth rates of gross domestic product and inflation,[a] 1995-1996.[b] Selected economies of the ESCAP region**

(Percentage)

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

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

[a] Refers to changes in the consumer price index except for Fiji for which change in GDP deflator has been reported. [b] The forecasts for countries relate to fiscal years defined as follows: FY 1993/94 = 1993 for India; FY 1992/93 = 1993 for Bangladesh, Pakistan and Nepal. [c] Based on data for 21 developing economies (including Taiwan Province of China) representing more than 95 per cent of the population of the region; GDP at market prices in United States dollars in 1990 have been used as weights to calculate the regional growth rates.

economies in 1994 increased only marginally, that of the South Asian economies registered an improvement by nearly a full percentage point. The performance of the least developed countries also improved by a similar magnitude.

The economies of East Asia (comprising China, Hong Kong and the Republic of Korea) were estimated to have grown by an average of 9.8 per cent in 1994 as against 9.7 per cent in 1993. Among this subgroup of countries there was a major resurgence of growth in the Republic of Korea, while China recorded a drop in its growth rate by about 2 per cent because of the policy measures implemented since 1993 to arrest inflation. The prospects for the next two years for these economies remain bright. Hong Kong is likely to maintain its present growth rate while in the Republic of Korea there could be a minor deceleration compared with the very high rate achieved in 1994. In China also it is expected that a further strengthening of anti-inflationary measures will slow down the growth rate by 1 to 2 percentage points.

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

As noted above, there was about a full percentage point increase in the average growth performance of the South Asian countries (comprising

Box II.1. Sustaining growth momentum through human capital formation

Economic growth in a country occurs as a result of increased use of its resource base (labour, raw materials and capital goods) or increased efficiency in the use of these resources or both. There are finite limits to possible increases in the resource base. Thus, sustained growth in the long run requires the enhanced productivity of resources. The term "productivity" is a measure of the degree of efficiency with which resources of all kinds are transformed into outputs.[a] The level of productivity in an economy is influenced by a number of factors including the technology processes being used, the level of managerial efficiency, skills and efforts of workers, incentives provided to workers, government economic policies and changes in the terms of trade. Among these, human capital is perhaps the most crucial as it is a prerequisite for others, such as technological improvements. Therefore, the development of human resources through education and training has increasingly engaged the attention of policy makers in the region.[b]

Improvements in human capital are effected mainly through formal education and post-employment training. A formal education system has several components. Primary and secondary level education are needed to help workers become more mobile and to increase their absorptive capacity generally. Vocational and technical educational institutions are required to meet the needs for specialized skills. Higher level learning institutions, such as universities, produce managers, researchers and policy technocrats. Governments have usually provided these educational facilities for their population. However, fiscal restraints are in many cases imposing limits on education budgets. While Governments continue to provide primary, and often secondary, education virtually free, further education is fee-based and provided through a variety of arrangements involving the private sector. This structure takes into account the externalities associated with education and training in terms of the accumulated benefits to the individual recipients, to employers and to the country as a whole.

Production techniques are increasingly becoming sophisticated and can be absorbed only by those with a certain minimum level of education. A higher level of basic education also increases labour force flexibility. Therefore, Governments have striven to raise the general level of education of their population, primary education being compulsory, and free, in most countries. Gross enrolment ratios at primary and secondary education levels, although quite low in some countries, have been steadily rising over time. Nevertheless, high rates of adult illiteracy still prevail in a number of countries, especially in South Asia. Moreover, the level of general education, defined in terms of mean years of schooling for the population of 25 years of age and over, is quite low in most countries. In 1992, as compared with around 12 mean years of schooling in developed countries, most developing countries in the region had 5 or less mean years of schooling.[c] Countries with higher mean years of schooling included the Republic of Korea (9.3), the Philippines (7.6), Sri Lanka (7.2) and Mongolia (7.0). In countries where school enrolment ratios are low, extra efforts are being undertaken to raise them quickly. These rising enrolment rates are expected to raise the mean years of schooling in most countries in the near future.

Vocational and technical education develops specialized skills that a worker can use on the job. Countries with a relatively high share (around 10 per cent or more in 1990) of vocational and technical education within total enrolment in secondary education included China, Fiji, Indonesia, the Republic of Korea, Papua New Guinea, Solomon Islands and Thailand. The private sector has been augmenting the efforts of the public sector in this area. For example, private vocational schools, licensed and subsidized to varying extents by Governments, have enrolled in recent years 46 per cent of the vocational students in Bangladesh, 62 per cent in Indonesia and 43 per cent in Thailand at secondary and post-secondary levels.[d]

While technical education has been promoted to enhance productivity as well as to tackle the problem of unemployment, in some countries fresh graduates from vocational institutions face great difficulties over long

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[a] For a detailed discussion on the measurement of productivity, see Asian Productivity Organization, "Productivity measurement: theory and practice in Asia", selected papers from APO Symposium and Workshop, 1975 and 1979, Tokyo.

[b] The subject of human resources development is taken up in much detail in ESCAP, *Strengthening Regional Cooperation in Human Resources Development, with Special Reference to the Social Implications of Sustainable Economic Growth in Asia and the Pacific* (ST/ESCAP/1467), 1995.

[c] United Nations Development Programme, *Human Development Report 1994* (Delhi, Oxford University Press, 1994), pp. 138-139.

[d] J. Middleton, A. Ziderman and A.V. Adams, *Skills for Productivity: Vocational Education and Training in Developing Countries* (New York, Oxford University Press, 1993), p. 31.

(Continued overleaf)

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periods in finding wage employment. With the expanding role of the private sector, the importance and attractiveness of self-employment is increasing. Unemployed persons with technical skills can start their own businesses. However, technical skills alone are not sufficient: a self-employed person also needs the ability to mobilize capital, organize production and find a market for his or her product. Therefore, some business management education, especially in countries where the problem of unemployment is serious, should be an integral part of the curriculum of vocational and technical education institutions.

A major source of acquisition of technical skills has been post-employment training in the form of on-the-job learning or through formal programmes financed by employers in both the private and public sectors and provided either in the work place or in external training institutions. It is generally recognized that even those who enter the job market with technical education may need further training to perform specific tasks. As its role in the economy increases, the private sector will have to assume greater responsibility in providing post-employment training; the private sector is in a better position to judge its skill requirements. In fact, in Japan and the Republic of Korea, most of the skills development of workers has been taking place through post-employment training. However, many enterprises in developing countries, especially small and medium ones, do not have enough resources to provide such training. In addition, in situations of a high turn-over of workers, investment in them is not attractive for employers. Therefore, Governments have to play an active role in vocational and technical education and training programmes for workers. They can induce and help employers, especially those in the private sector, to improve the skills of their workers through the provision of tax incentives, subsidies and technical assistance.

Many countries are facing a serious problem of mismatch between demand and supply of skills of their work force, leading to unemployment on one hand and a shortage of certain skills on the other hand. This problem of mismatch can be tackled through effective human resources planning by the Government, keeping in view future needs and the demand for various types of skills. Private sector involvement in this endeavour has been very useful. For example, in Malaysia, the local government established the Penang Skills Development Centre in 1989.[e] Hewlett Packard, Hitachi and 22 other foreign companies located in that area contributed money, equipment and technical assistance. The Penang Development Corporation provided the physical facilities and administration for vocational training, and the Science University of Malaysia, academic advice. This tripartite partnership ensures a vocational curriculum that keeps pace with the skills demanded by the private sector. At the same time, the overhead costs of vocational training are shared with the private sector. Therefore, increasing the role of market forces in determining the amount and kind of training provided can improve the effectiveness and efficiency of publicly provided training.

In the emerging new environment, Governments may become constrained to reduce their role as a direct provider of education beyond certain levels, but will have to assume a greater responsibility for coordinating and supervising the activities of private educational institutions. This, in turn, will help in meeting the variety and the quality of education required of the workforce. Governments may also have to play a role in ensuring that privately provided education is accessible on the basis of ability, not simply income. Otherwise private sector education can reinforce existing inequalities in income distribution.

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[e] D.S. Tachiki, "Human capital formation: public policy approaches in the developing Asia-Pacific economies", *Pacific Business and Industries: RIM*, vol. IV, No. 26 (Tokyo, Sakura Institute of Research, 1994), pp. 47-48.

India, the Islamic Republic of Iran, Pakistan and Sri Lanka) in 1994. This was largely due to an improved performance in India and Pakistan. A further acceleration of growth in these two countries is anticipated during the next two years on the assumption of sustained momentum in economic policy reforms. Despite progressive structural changes, agriculture still plays a significant role in these economies and, therefore, overall growth performance will remain subject to variations in weather conditions.

The Central Asian republics continued to be haunted by the spectre of hyper-inflation and falling output. Despite the traumatic experiences of a drastic reduction in per capita real income, it is significant that these countries have persevered in their pursuit of wide-ranging reforms. In some of these countries there has been a moderation in output decline and by the end of 1995, some of them are expected to record a positive growth rate.

Among the Pacific island countries, Papua New Guinea commands a heavy weight in terms of its economic size. The average performance of this group is, therefore, largely determined by what happens in Papua New Guinea. In 1994, the average growth rate of these economies must have become substantially lower than the 10.5 per cent achieved in 1993 because the unusually high growth rate of 14.4 per cent in Papua New Guinea in that year dropped drastically. The future prospects of these countries will remain heavily dependent on the prices of their primary commodity exports and on access to external resources which largely finance their development programmes.

As mentioned earlier, there was an improvement in the average growth performance of the least developed countries in 1994. This was led by a major acceleration in the Lao People's Democratic Republic and Nepal and rather mild improvements in Bangladesh and Myanmar. In common with the Pacific island countries, many of the least developed countries are also dependent on primary commodity exports. A few of these countries have recently been able to bring about some structural change by substantially augmenting exports of light manufacturing goods, particularly textiles, and tourism services. The prospects of these countries will be determined by the effectiveness with which they can implement their recent policy and institutional reforms and their ability to accelerate the mobilization of domestic resources.

PERFORMANCE AND POLICY RESPONSES BY SUBGROUPS

Least developed countries

In 1994 the least developed countries in the region experienced growth rates of around 4 to 6 per cent, which is about the same as in previous years. Their average rate of growth improved to 5.4 per cent from 4.8 per cent in 1993. They all devoted considerable attention to maintaining macroeconomic stability and a measure of success was attained in several countries such as in Bangladesh, the Lao People's Democratic Republic, Nepal and Solomon Islands. Inflation was reduced, stable and market-determined exchange rates were established, fiscal and current account deficits were narrowed, and foreign exchange reserves rose.

But there were others where persistent macroeconomic imbalances were a cause for concern. In the Maldives, the rapid growth of the past years based on expansionary fiscal policy and heavy public investment in economic and social infrastructure brought about unsustainable fiscal and current account imbalances that required urgent remedial action. In Myanmar, high inflation and an overvalued exchange rate remain major problems.

However, macroeconomic stability, although essential, is not a sufficient condition for sustained development in the least developed countries. The transition from stability to growth is a challenging task and the achievement of sound macroeconomic fundamentals is not immediately translated into higher investment and growth, as demonstrated by experience in countries such as Bangladesh and Nepal.

There has thus been a renewed emphasis on increased domestic resource mobilization to accelerate growth and the least developed countries have been making greater efforts aimed at fiscal and financial reforms to stimulate greater saving and investment, and greater efficiency in the use of resources. Privatization programmes and measures to improve the efficiency of public enterprises have been pursued by all the countries in order to reduce the losses of these enterprises which entail a huge drain on public resources.

Moreover, efforts were made to implement market-oriented reforms and to achieve greater private sector participation in the economy. But progress has been slow. Although liberalization and decontrol measures have been adopted and many laws and regulations have been passed to improve economic management and to create a more conducive climate for private sector participation in development, their implementation remains far from satisfactory. Aside from limited administrative capacity, slow progress has also been due to non-economic constraints. These include political instability, difficulty in arriving at a national consensus, vested interests, bureaucratic inertia and resistance to change, institutional and infrastructural weaknesses, and inadequate entrepreneurial ability.

Output growth

GDP growth in Bangladesh was estimated to be 5.0 per cent in 1994 (see table II.2), falling short of the 6 per cent target set for the year, but above the 4.5 per cent increase attained in 1993. The rate of growth of agricultural output at 2.6 per cent in 1994 was the highest during the 1990s. Agriculture accounts for over one third of GDP, employs 60 per cent of the labour force and occupies a key place in the country's development strategy.

Table II.2. Growth rates, 1991-1994. Selected least developed countries in the ESCAP region

(Percentage)

		Rates of growth			
		Gross domestic product	*Agriculture*	*Industry*	*Services*
Bangladesh	1991	3.4	1.6	4.3	3.8
	1992	4.2	2.2	7.1	4.0
	1993	4.5	1.9	7.4	4.4
	1994	5.0	2.6	8.3	5.5
Bhutan	1991	5.4	3.2	5.5	8.3
	1992	4.5	3.5	6.2	4.9
	1993	5.0	3.0	6.0	7.0
Cambodia	1991	7.6	6.7	8.9	8.5
	1992	7.0	1.9	15.6	11.1
	1993	5.7	3.2	10.0	7.2
Kiribati	1991	0.5	12.2	−20.1	−0.5
	1992	4.0	1.6	−10.8	7.6
	1993	2.9	2.2	2.1	1.6
Lao People's Democratic Republic	1991	4.0	−1.7	19.9	8.8
	1992	7.0	7.9	7.3	3.9
	1993	4.0	0.0	11.0	9.2
Maldives	1991	7.6	6.3	9.8	6.7
	1992	6.3	−1.5	9.0	8.5
	1993	6.2	−0.4	8.4	7.9
	1994	5.9	..	..	..
Myanmar[a]	1991	−1.0	−2.4	0.1	0.3
	1992	9.3	13.6	11.8	7.4
	1993	6.0	7.5	1.8	5.2
	1994	6.4	..	..	..
Nepal[b]	1991	4.6	2.8	7.2	..
	1992	2.1	−1.2	6.6	..
	1993	2.9	−1.2	8.3	..
	1994	7.8	7.7	7.8	..
Samoa	1991	−1.6	−4.1	−9.7	5.1
	1992	−4.2	−10.5	0.0	0.8
	1993	4.8	..	..	..
Solomon Islands	1991	3.2	2.0	−3.2	5.3
	1992	8.2	..	..	..
	1993	6.0	..	..	..
Tuvalu	1991	11.4	10.0	11.7	11.9
	1992	8.9	8.0	9.1	9.1
	1993	8.7	8.0	7.5	9.4
Vanuatu	1991	3.5	−2.0	5.3	5.1
	1992	−0.1	−5.2	2.0	1.2
	1993	2.0	..	..	..

Sources: ESCAP based on International Monetary Fund, *International Financial Statistics*, vol. XLVII, No. 10 (October 1994); Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries, 1994* (Oxford University Press, 1994) and *Asian Development Outlook 1994* (Oxford University Press, 1994); and national sources.

Note: Data for 1994 are estimates.

[a] GDP at 1985/86 producers' prices. [b] Industry includes services.

Over the past two decades a major objective of the country has been to achieve self-sufficiency in foodgrains production. This objective has now been largely attained owing to a considerable expansion of irrigation, improved agricultural practices such as the use of fertilizers and better seeds, and a more favourable and supportive policy environment that has increased the access of farmers to new technology and to agricultural inputs and services. Against the target of 20 million tons set for the year, cereals output was estimated to be 19.7 million tons in 1994, a marginal increase over the 19.5 million tons produced in 1993. Although many sectors of the economy have been liberalized, selected forms of public intervention in food management are expected to continue for some time in order to respond to the basic needs of the large masses of the rural and the urban poor living below the poverty line.

As in the case of agriculture, the growth of the industrial sector estimated at 8.3 per cent in 1994 was the highest during the current decade. Moreover, the rate has shown a consistently upward trend over the past few years. Export-oriented industries, and especially ready-made garments, provided the main impetus to industrial growth. As for the services sector, its overall growth in 1994 was estimated to have increased to 5.5 from 4.4 per cent in the previous year, with public administration registering the largest increase.

GDP growth in Bhutan was 5.0 per cent in 1993 compared with 4.5 per cent in 1992. Growth of both agricultural and industrial sectors slowed in 1993. Bad weather, social unrest in the south and restraints on logging reduced agricultural growth to 3 per cent, compared with 3.5 per cent in the previous year. Industrial growth at 6 per cent in 1993 was marginally lower than in 1992. However, the services sector performed better in 1993, posting a 7 per cent growth compared with 4.9 per cent in 1992. Increased earnings from the hotel and tourist sector largely accounted for this increase.

In Cambodia, GDP growth fell to 5.7 per cent in 1993 from 7 per cent in 1992. The presence of land mines in the fields and increased flooding as a result of damage to dams, flood gates and irrigation channels from years of war and neglect were the main constraints to agricultural production. The sector, nevertheless, grew at 3.2 per cent in 1993, up from 1.9 per cent in the previous year. As in neighbouring countries, environmental concerns have led to various restrictions on logging and the forestry sector output is reported to have fallen by 73 per cent in 1993. Growth in the industrial sector also fell from 15.6 per cent in 1992 to 10 per cent in 1993 largely because of a sharp drop in construction activity. Growth in the service sector was similarly affected and declined to 7.2 per cent in 1993 compared with 11.1 per cent in the previous year.

The economy of Kiribati grew at an estimated rate of 2.9 per cent in 1993, marking three consecutive years of positive growth. Even though unfavourable weather conditions adversely affected copra output, the overall GDP grew because of a substantial increase in commercial fishing, the development of seaweed as an export item and a high level of construction activity. However, because of the fact that the population also grew at 2.1 per cent in 1993, the per capita income showed only a small improvement over the previous year.

Subsistence production mainly in agriculture and fishing occupies about half of the labour force and contributes about 17 per cent of GDP. Copra production is the main private sector economic activity. Fisheries production has been on a subsistence basis in the past. Recently, the Government has tried to commercialize and diversify fishing. The manufacturing sector is small and confined to a few small scale, simple products. There has been some rise in construction activities, wholesale and retail trade, and in government services. In the service sector, tourism has a great potential. However, the poor transport facilities to the island have been a major problem in attracting tourists. In order to alleviate the situation, the Government re-opened Kanton airport and upgraded Bonriki airport in 1994.

In the Lao People's Democratic Republic, GDP growth in 1993 was lower than in 1992. The fall has been caused by a sharp decline in agricultural growth. The agriculture sector accounts for 60 per cent of GDP and largely determines the country's economic performance. However, in 1993 the effect of the poor harvest had been moderated by high growth in the industrial and services sectors. A 36.5 per cent increase in mining and quarrying and a 21.1 per cent increase in electricity production underline the good performance in the industrial sector. As for the service sector, the wholesale and retail trade posted the highest increase at 18.5 per cent in 1993, followed by hotel and restaurant (14.8 per cent) and banking (13.2 per cent).

After a decade of remarkable progress in the 1980s with GDP increasing at an average annual rate of 10 per cent, growth in the Maldives began to slow during its Third Plan period (1991-1993). GDP growth declined from a high of 16.2 per cent in 1990 to 6.2 per cent in 1993.

The slow-down in the economy is largely explained by poor performance in the fisheries and the tourism sectors which together account for 30 per cent of GDP. In 1993 the fisheries sector showed a negative growth of 3 per cent owing to falling world demand and lower prices. Growth also slowed in the tourism sector from 8 per cent in 1992 to 3 per cent in 1993 because of continued weak demand in some European countries that provide the main market for the tourist industry of Maldives.

The manufacturing sector consisting mostly of garment production, boat building and handicrafts accounts for only 6 per cent of GDP and has been constrained by a shortage of labour, a small and fragmented domestic market and high transport costs. However, the expansionary financial policy has resulted in a sharp rise in construction and in distribution. The share of construction in GDP rose from 8.6 per cent in 1990 to 9.2 per cent in 1993 while the share of distribution in GDP increased from 17 to 19.1 per cent over the same period.

The economy has been facing capacity constraints as evidenced by the emergence of large macroeconomic imbalances in 1993. In view of these difficulties, the growth target for the Fourth Plan (1994-1996) has been set at a modest average annual rate of 5 per cent.

After experiencing negative growth in 1991 the economy of Myanmar achieved a record high growth rate in 1992, fuelled largely by a dramatic increase in agricultural output. Estimates for 1994 indicate that economic growth as well as agricultural production has been reduced to a more modest level of 6.4 and 5.4 per cent respectively. About 50 per cent of the sown agricultural area is devoted to rice cultivation, and the paddy output in 1993 rose to 17.4 million metric tons from 14.8 million tons in 1992. The rise in the sown area by 1.8 million acres and improvement in yields owing to favourable weather were the main factors in this increase.

Growth in the manufacturing sector in 1993 was constrained by low capacity utilization resulting from shortages and unreliable supplies of energy, transport difficulties and competition from cheap consumer goods from across the border. However, mining registered a growth of over 20 per cent.

Growth in the service sector in 1993 remained sluggish compared with the previous year, mainly because of slow growth of around 4 per cent in the transport and communications sector. The financial services sector maintained a high growth of 18.8 per cent in 1993 with greater participation by the private sector in providing banking and financial services. However, owing to its negligible share in GDP, estimated to be 0.8 per cent, it has had no significant impact on the service sector as a whole.

Nepal suffered serious floods and landslides in mid-1993 which severely damaged transport and other physical infrastructure, including the country's largest hydroelectric power station which supplies 40 per cent of the nation's electricity needs. Nevertheless, owing to favourable weather, GDP growth in 1994 was estimated to rebound to nearly 8 per cent from a low of 3 per cent in 1993.

The agriculture sector which registered negative growth in the two previous years grew at 7.7 per cent in 1994. The favourable impact of reform measures, particularly those aimed at a greater private sector role in the economy, spurred manufacturing growth to 11.7 per cent in 1994. However, there is some concern regarding the fall in tourist arrivals which dropped by 12.2 per cent in the calendar year 1993.

The economy of Samoa has been devastated by successive cyclones over the past three years. After showing a negative growth rate of GDP over the 1990-1992 period, the economy is finally showing signs of recovery. In 1993, GDP grew by 4.8 per cent.

The agriculture sector which accounts for about 40 per cent of GDP, was severely affected by cyclones. This sector showed negative growth rates from 1990 to 1992. The performance of the agriculture sector improved in 1993 with high yields in the production of root crops and coconut products. However, the production of taro fell substantially as taro leaves were struck with disease. The performance of the industrial sector has improved in recent years, after showing negative growth rates in 1990 and 1991. The establishment of an automobile electrical wiring industry has significantly boosted industrial output. The service sector has consistently shown positive growth rates. However, in 1992, the growth rate of this sector declined to

0.8 per cent from that of 5.1 per cent in 1991. Within this sector, restaurants, hotels, and distribution services registered the fastest growth rate. The success of these industries was largely related to tourism.

The economy of Solomon Islands grew at the rate of 6 per cent in 1993, lower than that of 8.2 per cent in the previous year. The overall economy slowed in spite of the boom in logging activities because of the poor performance of other primary commodities and the fishing industry.

Logging activities continued unabated at a rate estimated to be twice the sustainable level during the first quarter of 1994. The Government is concerned that at the current rate of logging, the resources will be exhausted by about the end of the century. In order to curb logging activities, the Government has announced two measures: new taxes of up to 70 per cent on raw log exports; and a ban on round log exports to be introduced in 1997.

The other major primary products have registered poor performances. Copra production went down in 1993 reflecting bad weather conditions, increased consumption of green coconuts, and the overall low economic return of producing copra. Cocoa production also fell in 1993. The decline was mainly because the Solomon Islands Plantations, one of the two largest cocoa plantations, converted 240 hectares previously under cocoa plantation to oil palm production in 1993. The commercial fishing industry also experienced low fish catches, with the catch in 1993 down by 20 per cent over the past years.

The economy of Tuvalu grew at an estimated rate of 8.7 per cent in 1993, almost at the same rate as in the previous year. The strongest growth was registered in subsistence agriculture and fisheries. The other important sectors were construction, trade, and government services.

Subsistence agriculture is the most important sector in the economy employing about 75 per cent of the work force. Among commercial crops, coconut products are of prime importance to the country, as they are a major source of export revenue.

Among the Pacific island economies, Tuvalu's growth performance has been the most outstanding with over 7 per cent growth throughout the 1990s. Estimates for 1994 indicate considerably lower growth rate because of a slow down in fisheries and public expenditure.

The economy of Vanuatu grew at a modest rate of 2 per cent in 1993 after experiencing a negative growth rate in 1992.

The agriculture sector experienced a negative growth rate of -5.2 per cent in 1992. The traditional agriculture comprises subsistence farming of root crops, tropical fruits, coastal fishing, and livestock. In recent years, the country has supported the production of export commodities such as copra, beef, cocoa, and coffee. Some new exports crops such as pepper, vanilla and kava with greater potential for expansion have also emerged. There are prospects of mining manganese, copper, gold and petroleum.

The industrial sector grew at the rate of 2 per cent in 1992. The main industry is food processing which accounts for 37 per cent of manufacturing output. The other important industries are metal fabrication, footwear and apparel, and sawmills. Although the investment in the industrial sector is high, the productivity of the sector is low. There is considerable scope to improve the performance of this sector through increased competition, provision of better infrastructure, and investment in education and training of the employees.

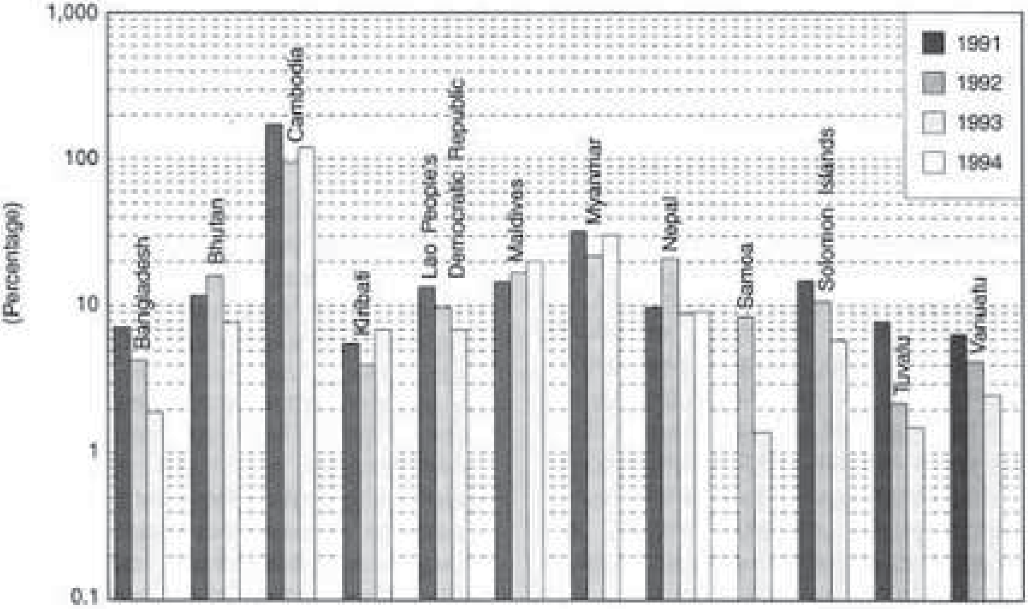
The growth rate of the service sector was 1.2 per cent in 1992. This sector contributes the most to GDP. However, about 80 per cent of the population is still supported by subsistence agriculture. Tourism which is the most important activity in this sector could be further developed.

Other indicators of macroeconomic performance

The structural reform programme initiated in Bangladesh four years ago has begun to bear results. By 1993, notable progress had been made in restoring macroeconomic stability. Inflation in that year was down to a low of 1.9 per cent from 7.2 per cent recorded in 1991 (figure II.1). Price stability was maintained in the first half of 1994 when the consumer price index increased by only 1.2 per cent. Expansion of the broad money supply (M_2) over the same period was 4.9 per cent representing a slight increase from 4.5 per cent during the corresponding period of the preceding year.

The fiscal position remained sound. The percentage of the fiscal deficit to GDP in 1993, excluding grants, was -5.3 per cent. This has been achieved by better revenue collection which

Figure II.1. Inflation rates,[a] 1991-1994. Selected least developed countries in the ESCAP region



Sources: See the source notes in table II.2.

Note: Scale on the vertical axis is in logarithm.

[a] Refer to changes in consumer price index.

increased to 11.7 per cent of GDP in 1993 from 10.9 per cent in 1992. The increase in expenditure was kept low from 8.3 to 8.6 per cent of GDP. However, the low implementation rate of the annual development plan has also been held partly responsible for the low fiscal deficit. Savings as a proportion of GDP have consistently increased throughout the 1990s leading to some narrowing of the saving-investment gap (table II.3). In 1993, gross fixed investment as a ratio of GDP increased to 13.5 from 12.1 per cent in 1992. Gross domestic savings also rose from 5.8 to 6.2 per cent over the same period. Although well below other South Asian countries, this represents a significant improvement over the less than 3 per cent rate of the late 1980s.

There was a marked decline in the inflation rate in Bhutan in 1993 when it fell to 7.8 from 16 per cent in 1992. This was the result of reduced inflationary pressures in India with which Bhutan has close economic links. 1993 also witnessed a sharp increase in the current account deficit which rose to 20.8 per cent of GDP compared with 6.8 per cent in the previous year. The upsurge is accounted for by an unusual outlay on the import side, namely, the purchase of an additional aircraft for the national airline. In the absence of this exceptional outlay, the current account deficit would have shown no substantive change from the previous year. There has, however, been a significant turn-round in the fiscal balance from a deficit of -4.1 per cent in 1992 to a surplus of 4.6 per cent. This has been achieved by a concerted effort at increasing revenue through higher taxes and better tax administration while restraining current expenditure growth.

Generous financial support from the international community boosted gross domestic investment in Cambodia to 14 per cent of GDP in 1993 from 9.8 per cent in 1992. Gross domestic savings also increased to 8.3 per cent of GDP from 7.5 per cent in 1992. However, the inflation rate which had fallen to 94.7 per cent in 1992 from a high of 171.5 per cent in 1991, rose again to 120.2 per cent in 1993, while the current account deficit as well as the fiscal deficit widened further as a proportion of GDP.

Table II.3. Summary of macroeconomic indicators, 1990-1993. Selected least developed countries in the ESCAP region

(Percentage)

		1990	*1991*	*1992*	*1993*
Bangladesh	Savings/GDP	2.7	4.1	5.8	6.2
	Investment/GDP	12.8	11.5	12.1	13.5
	Budgetary balance/GDP	–0.1	2.5	2.2	1.6
	Money supply growth	9.6	7.7	13.6	16.0
Bhutan	Savings/GDP	22.9	15.8	5.4	17.3
	Investment/GDP	33.0	30.6	38.3	38.3
	Budgetary balance/GDP	–7.9	–0.8	–4.1	4.6
	Money supply growth	– 1.1	38.9	12.1	..
Cambodia	Savings/GDP	3.0	7.7	7.5	8.3
	Investment/GDP	8.3	9.4	9.8	14.0
	Budgetary balance/GDP[a]	–4.5	–3.4	–3.6	–5.7
	Money supply growth	240.6	27.4	141.5	25.6
Kiribati	Savings/GDP	–12.3	–20.5	–22.4	..
	Investment/GDP	82.3	63.8	56.2	..
	Budgetary balance/GDP	18.1	31.1	25.5	7.8
	Money supply growth	..	..	..	..
Lao People's Democratic Republic	Savings/GDP	0.8	2.0	3.6	..
	Investment/GDP	14.8	13.0	14.4	..
	Budgetary balance/GDP[a]	–13.5	–9.5	–8.8	–7.4
	Money supply growth	–0.1	12.5	24.5	..
Maldives	Savings/GDP	11.3	..	..	..
	Investment/GDP	64.2	..	..	..
	Budgetary balance/GDP[a]	–14.0	–15.8	–18.9	–17.2
	Money supply growth	18.9	28.5	15.4	49.7
Myanmar	Savings/GDP	11.7	14.4	13.1	12.3
	Investment/GDP	13.4	15.8	14.1	13.3
	Budgetary balance/GDP	–5.1	–5.0	–4.9	..
	Money supply growth	43.5	35.3	37.6	..
Nepal	Savings/GDP	7.3	7.4	9.4	9.7
	Investment/GDP	19.4	21.1	21.9	20.7
	Budgetary balance/GDP[a]	–10.5	–11.6	–9.3	–10.0
	Money supply growth	21.2	24.0	16.0	23.9
Samoa	Savings/GDP	..	..	..	..
	Investment/GDP	..	..	..	..
	Budgetary balance/GDP	4.1	9.9	–5.3	–1.5
	Money supply growth	42.6	–9.2	–11.4	9.4
Solomon Islands	Savings/GDP	..	..	..	..
	Investment/GDP	32.1	32.5	33.0	..
	Budgetary balance/GDP[a]	–12.1	–14.9	–20.1	–16.2
	Money supply growth	26.6	23.4	31.9	18.1
Tuvalu	Savings/GDP	–7.0	–14.0	..	..
	Investment/GDP	39.0	36.0	..	..
	Budgetary balance/GDP	–2.3	9.1	57.6	25.2
	Money supply growth	0.0	..	..	..

(Continued on next page)

Table II.3 *(continued)*

(Percentage)

		1990	*1991*	*1992*	*1993*
Vanuatu	Savings/GDP	8.8	7.6	7.8	10.0
	Investment/GDP	43.6	35.0	36.0	36.0
	Budgetary balance/GDP	-7.8	-6.7	-7.1	..
	Money supply growth	-10.9	12.4	15.5	12.3

Sources: ESCAP based on International Monetary Fund, *International Financial Statistics*, various issues; Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries, 1994* (Oxford University Press, 1994) and *Asian Development Outlook* (Oxford University Press, 1994); and national sources.

Note: Money supply refers to M_1.

[a] Excluding grants and net lending.

Inflation in Kiribati has been on an average about 5 per cent since the 1990s. The prices in Kiribati are tied to inflation in Australia from which most of Kiribati's imports are procured. The government budget consists of two parts, recurrent and development budget. The recurrent revenue has been growing faster than expenditures. The surplus in the recurrent budget has resulted in less dependence on external finance. On the development budget side, local funds have been insufficient to cover development expenditures. In 1993, the Government financed only 3.4 per cent of the total development budget from domestic revenues. The remainder was externally financed through foreign aid and loans. Despite the substantial external resources available to Kiribati, there is an urgent need to increase the Government's capacity to utilize aid, particularly in the outer islands.

The rate of inflation in the Lao People's Democratic Republic fell to 7 per cent in 1993 from 9.8 per cent in 1992 mainly because of a decline in food prices. Exchange rate stability was also maintained in 1993 with the kip per dollar rate remaining constant.

In 1992, the domestic saving rate at 3.6 per cent of GDP was the lowest among the least developed countries. With gross domestic investment at about 14 per cent, the resource gap amounts to around 10 per cent of GDP. A significant achievement during the 1990s has been the reduction in the fiscal deficit because of strengthened tax efforts and more effective control of expenditure.

The large public sector investment in economic and social infrastructure and increased expenditures on public sector employment led to large fiscal deficits in the Maldives which reached close to 20 per cent of GDP in 1992 and 1993. The fiscal deficit, met mainly through domestic borrowing, posed a serious threat to sustainable development as it led to inflation, placed increased pressures on the balance of payments and crowded out private investment. The broad money supply also marked a steep increase. All these factors led to a further deterioration in the current account balance while exchange reserves fell to a low level of less than two months' imports. Grant aid has also been steadily declining over the past few years.

In Myanmar, the saving-investment gap and current account deficit have generally been low. But the persistence of a budget deficit and high rates of money supply growth have caused high rates of inflation which was estimated to be 27 per cent in September 1994.

In Nepal, the removal of subsidies and adoption of liberalizing measures in 1992 brought on an upsurge of prices and the inflation rate reached a record high of 21 per cent in that year. But as economic activity returned to normal, the increase in the consumer price index (CPI) dropped markedly in 1993, it was estimated to be 9.1 per cent in 1994. Improvement in the supply situation, a stable exchange rate, and lower interest and tariff rates have helped to dampen inflation as has low inflation in India because of the close trade links between the two countries. This period also saw a significant growth in money supply, accelerating to 24 per cent in 1993 from 16 per cent in 1992. However, monetary expansion was projected to decline in 1994.

The budget deficit financed by domestic borrowing has been a significant factor in adding to inflationary pressures and the fiscal deficit in 1993 estimated at 10 per cent of GDP is on the high side. Revenue has remained stagnant over the past years at around 10 per cent of GDP while expenditures are much larger at around 20 per cent and are growing. Several measures were, therefore, introduced in 1994 aimed both at raising revenue and controlling expenditures to redress the problem.

In 1993, domestic savings stood at 9.7 per cent of GDP, at about the same level as in 1992 while gross domestic investment fell slightly to 20.7 per cent of GDP from 21.9 per cent over the same period. The investment rate is expected to rise in the years ahead because of heavy public investment in the energy sector and increased private investment in response to liberalization measures. With slow growth in the savings rate, the resource gap is likely to widen.

There is a high propensity to consume in Samoa. Savings as a percentage of GDP have been estimated to be negative since 1990. In contrast, the domestic investment has been quite high. The substantial portion of domestic investment is financed by remittances from Samoan citizens living abroad. However, there still remains a resource gap between saving and investment.

The government budgetary balance has moved to a deficit since 1992. This was mainly because of the increase in the government expenditure on reconstruction and rehabilitation following cyclones Ofa and Val. In 1993, the budgetary deficit declined as the government expenditure on cyclone repairs went down. A relatively large portion of government budget deficits have been financed by external grants as relief for cyclones, and by a modest increase in external debt. Hence, the Government has not been compelled to increase domestic money supply to finance the budget deficits.

In Solomon Islands, inflation which moderated to 5.9 per cent in 1993, is again showing signs of increase. Up to April 1994, the prices had risen by 11.8 per cent in response to the increase in domestic demand caused by a rise in public sector wages, budget deficits, and the rise in income related to the logging sector boom.

Despite an increase in government revenues, fiscal deficits remained high. The main cause for the deficit is excessive government expenditure rather than poor revenue receipts. Several taxation changes were also introduced in early 1994, including an 8 per cent goods tax, an expansion in the coverage of the sales tax, and a 47 per cent tax imposed on high income earners. However, the efforts to reduce public expenditure are not having significant success. This is evident from the fact that the Government is resorting to heavy domestic borrowing from the financial system despite increased revenue collection. By April 1994, the Government had already borrowed SI$ 26 million, which exceeded the budgeted ceiling for 1994. Thus, control of public expenditure constitutes a major policy challenge for Solomon Islands.

Inflation in Tuvalu has been low and has fallen further from 2.2 per cent in 1992 to a mere 1.5 per cent in 1993. Domestic inflation is strongly influenced by the rate of inflation in Australia, Fiji, and New Zealand – the countries from which most of Tuvalu's imports are sourced, and by exchange rate fluctuations of the Australian dollar which is used as the local currency.

The government budget consists of recurrent and development budget. In recurrent budget, the expenditure increased by over 21 per cent largely because of a rise in civil service wages and an increase in employment in the public sector. The recurrent revenue also doubled because of an exceptionally large increase in fishing royalties and a special drawings from the Tuvalu Trust Fund which was established in 1987 from the aid contributions of donor countries. As a result, there was a large recurrent surplus of about 30 per cent of GDP in 1992. For 1993, the surplus was expected to fall to about 10 per cent of GDP. The combination of recurrent surplus and inflow of external assistance and grants to finance the development budget led to a large overall surplus in 1992 and 1993.

Inflation in Vanuatu also has been generally low, it was only 2.5 per cent in 1993. The country has always maintained a high level of domestic investment. In 1993, investment as a percentage of GDP was 36 per cent. Tourism is the main reason for the private investment boom. Consistently high rates of investment against the backdrop of low growth rates of GDP over the past years indicate low productivity. The savings rate in Vanuatu has been low, domestic saving as percentage of GDP being 10 per cent in 1993. The large resource gap between investment and saving has been financed by the inflow of external resources dominated by development aid.

The overall budget deficits have varied between 6 to 8 per cent of GDP since 1990. As the direct taxes in the country are very low, the government revenues are highly dependent on import duties which currently provide 66 per cent of tax revenues. The Government has recognized the adverse impact of high import duties and is consequently lowering the duties. In order to compensate for the decline in revenue, efforts are being made to broaden the tax base.

Policy challenges

Prospects for Bangladesh appear brighter with achievement of macroeconomic stability, but the transition from stability to growth is proving to be a challenging task. The policy imperative, therefore, is to build upon the stable economic environment that has been attained and to lift the economy on to a higher growth path in order to alleviate the severe poverty still faced by a high proportion of the country's population.

An acceleration of growth would require substantial increases in both the public and private sector investment which together now account for about 13 per cent of GDP. In common with many other least developed countries, Bangladesh has also sought to enhance the flow of foreign direct investment (see box II.2). The increase in investment would be greatly assisted by reforms in various areas, including the simplification of administrative procedures, the speeding up of privatization and other measures to deal with inefficient public enterprises whose losses now account for 2 per cent of GDP. In addition, improvements in economic coordination and management to increase the implementation rate of the annual development plan from the low rate of recent years would be helpful. Several measures in these areas are under implementation or consideration by the Government. For example, in November 1993 the Privatization Board, established earlier in that year, was given an autonomous status with the authority to recruit local and foreign consultants to assist in the privatization process. A comprehensive reform of the Companies and Bankruptcy Acts has been undertaken. Several organizations responsible for export promotion are being restructured under the umbrella of an export development action plan. However, the ability to accelerate the pace of growth through these measures will also be tempered by non-economic factors influencing both domestic and foreign investors' confidence.

In Bhutan, a high priority policy is to promote self-reliance in its development. Greater self-reliance implies not only an increased effort at domestic resource mobilization and a rise in saving and investment of both the public and the private sector, but also at human resources development in order to meet the growing need for skilled labour and professionals from the local population rather than relying on expatriates. These issues are highlighted in the current Seventh Five-year Plan (1992-1997).

In the 1980s, the good economic performance record of 7.4 per cent annual growth was based on the expansion of the power sector. In the Seventh Plan period, as some large power plants are only in the preliminary planning stage and will not come on stream until the late 1990s, the power sector is not expected to make a major contribution to growth. Instead, the manufacturing sector will be the main source of growth to achieve the annual 5.3 per cent target of the Seventh Plan. The manufacturing sector is projected to grow at 13.4 per cent a year and to nearly double its share of GDP from 7.2 per cent in 1989 to 13.2 per cent in 1997. This good performance is to come from investment in two large projects, namely, a ferro-silicon plant and a cement factory. It is also expected that there will be a growth of smaller manufacturing establishments with active private sector participation.

Cambodia has been making a determined effort to establish macroeconomic stability in order to restore confidence in the economy and to lay the foundation for reconstruction and long-term development. The National Bank of Cambodia has estimated that the inflation rate fell to 13.7 per cent in the first half of 1994 while the exchange rate remained relatively stable and foreign exchange reserves increased. Fiscal and financial reforms gained momentum, the budget was centralized and a foreign investment law was passed in 1994 which provided for liberal tax and tariff incentives for export-oriented production and for certain priority projects in infrastructure development, energy, and labour intensive industries. The Government's objective assessment of the country's economic problems and its commitment to bring about structural changes and reforms of the legal system were favourably received by the international donor community and pledges of external assistance since 1992 have amounted to $1.5 billion. To achieve the Government's economic growth target would require a major acceleration in private investment also, both domestic and foreign.

Box II.2. Foreign direct investment inflows: prospects for the least developed countries

The least developed countries in the ESCAP region have been facing chronic financial difficulties, reflected in persistent budget and external payment deficits, despite their usually low consumption and investment levels. They have traditionally relied upon external savings in the form of foreign aid to supplement their meagre domestic savings. In the face of possible stagnation or even diminution of official development assistance (ODA) flows in the future, the least developed countries have sought market-based sources of external financing among which foreign direct investment (FDI) is perhaps the most promising option. The reason is that with the present state of underdeveloped or non-existent financial and capital markets and poor credit worthiness, most of them are unlikely to be able to attract other private flows, such as portfolio investments and bank credit.

Moreover, FDI inflow to developing countries in the Asian and Pacific region has been growing rapidly. In 1994, the inflow was estimated at about $52 billion, a quantum jump over $30 billion recorded in 1992 when the developing ESCAP region accounted for nearly three fifths of flows to all developing countries. However, the principal beneficiaries of such inflows have been the more dynamic and large economies, such as China, the member countries of the Association of South East Asian Nations (ASEAN), and more recently, India.

The general air of optimism regarding the role of FDI does not hold for the least developed countries which still receive a very small share of total FDI inflows into the developing ESCAP region. In 1993, for instance, the share of the least developed countries was just over 4 per cent, representing an infinitesimal increase over the preceding year.

The growth in FDI inflows into the least developed countries in the region has remained slow despite their earnest efforts, since the late 1980s, to raise the participation of foreign investors through wide-ranging economic reforms which also included a host of investment incentives.[a] Most least developed countries in the region have already enacted foreign investment laws which simplify procedures for the approval of foreign investment projects and provide tax incentives for investors. The trend towards greater liberalization of FDI regulations in the least developed countries has also been accompanied in many cases by a variety of other economic reforms, such as trade liberalization, financial deregulation, the elimination of foreign exchange restrictions, and the privatization of state enterprises as an ongoing process. In Cambodia, for example, recent revisions to the foreign investment law of 1991 simplified procedures for the approval of private investment projects, provided tax incentives for investors, and eliminated foreign exchange restrictions that currently apply to investors. Myanmar recently introduced economic reforms in the financial sector, which included a relaxation of foreign exchange restrictions and the entry of foreign banks.[b] Similar economic reforms have been undertaken in most of the other least developed countries since the late 1980s.

The available evidence suggests that the liberalization policies may have brought some sizeable increase in the inflow of FDI in a few least developed countries. For instance, in 1993, Bangladesh received FDI inflows amounting to $14 million, up from an annual average of $2.2 million over the period 1986-1990. In the Lao People's Democratic Republic, FDI inflows were $48 million in 1993 compared with the average annual inflow of $2.4 million between 1986 to 1990. Some significant increase was also recorded for several other least developed countries such as Cambodia, Myanmar and Nepal.

Thus, there may be some potential for accelerating FDI inflows in a few least developed countries with comparatively larger populations and market size, natural resources of interest to foreign investors, and tourism potential. Even for those countries, however, FDI inflows presently amount to less than 1 per cent of their GDP. For example, over the period 1991-1992, the proportion of FDI to GDP for Bangladesh, the Lao People's Democratic Republic and Myanmar was 0.01, 0.83 and 0.03 respectively.[c] In contrast, the savings-investment gap for most of these countries is at least 10 per cent of GDP. It is, therefore, clear that even with a significant acceleration in FDI flows, the least developed countries' need for support through ODA will remain overwhelming in the foreseeable future.

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[a] For a brief survey of FDI liberalization measures in selected least developed countries see A.B.M.M. Azizul Islam and N. Majmudar, "Trends and issues in FDI laws in least developed countries", *The CTC Reporter*, No. 30 (Autumn, 1990).

[b] See *Myan View*, vol. 1, No. 1 (January 1995).

[c] United Nations Conference on Trade and Development, *World Investment Report 1994: Transnational Corporations, Employment and the Workplace* (United Nations publications, Sales No. E.94.II.A.14), table II.15, p. 65.

Kiribati has enjoyed an overall budget surplus for several years. This has been due largely to a heavy dependence on external assistance to finance its development budget. The country also needs to accelerate growth. An acceleration of growth coupled with a reduced dependence on external assistance would require the private sector to play a greater role in economic development. How to motivate the private sector to assume this role will be a major policy challenge for Kiribati in the years to come.

In the Lao People's Democratic Republic, policy reforms implemented within the framework of the new economic mechanism, an economic reform package adopted in 1986, encompassed removal of price controls and subsidies, decontrol of the distribution of goods and services, reform of the tax system, institution of market determined exchange rates and enactment of various legislation such as the Central Bank Law and the Foreign Investment Law. Institutional reforms were also initiated to restructure government ministries and departments to improve coordination and economic management. A privatization programme was adopted and efforts were made to establish a legal and regulatory environment supportive of private sector development.

As a result of these measures, inflation has been brought down to a single digit level, the exchange rate has been stabilized, and there have been improvements in both the fiscal and current account deficits. These favourable developments have had a notable impact on the manufacturing sector where there has been an inflow of foreign investment, particularly in the textile and garment sector. Recently, the Government has also drawn up a perspective plan to the year 2000 aimed at an average annual GDP growth of 8 per cent, maintaining exchange rate stability and keeping inflation down to less than 10 per cent a year and raising the investment rate at least to 15 per cent of GDP. Further efforts will be needed to improve administrative capacity, curb rent seeking and increase infrastructural facilities to reach these targets.

In Maldives, the major aim of economic policy has been to reduce the large fiscal deficit which has risen to nearly one fifth of GDP. Fiscal balance is to be restored through an increased tax effort, particularly by expanding the tax base and introducing new taxes and user charges. The high government expenditures on economic and social infrastructure will also have to be trimmed to a more sustainable level. At the same time, increased attention has been given to better coordination and management of resources by introducing institutional reforms and improving planning and monitoring. With a slowing down of public investment, increased reliance will have to be placed on the private sector for the continued development of key sectors of the economy such as fisheries and tourism. Hence an important policy objective has been to improve the legal and institutional underpinnings in the country to create a conducive environment for private sector development. High population growth, environmental degradation and the heavy reliance on expatriate labour for managerial and technical skills are other major issues to which the Government has been giving priority attention.

Myanmar has overcome the stagnation and low growth that had characterized the economy over the past few years and is now on a steady growth path. Market liberalization measures, decontrol of prices, greater participation of the private sector in the economy and other reforms aimed at the establishment of a market-oriented economy have continued. A major initiative is currently underway to boost tourism and 1996 has been designated as "Visit Myanmar Year". Another important objective has been to promote the inflow of foreign investment and as of March 1994, a total of 91 foreign investment projects amounting to $1 billion have been approved. About 70 per cent of the total value of this approved investment is in oil and gas exploration and development and the hotel and tourism sector. However, the high rate of inflation and the grossly over-valued exchange rate continue to pose difficulties.

In Nepal progress has been made in economic liberalization and in promoting private sector development. Reforms to reduce the involvement of the State in economic activities and efforts at deregulation in the key sectors of the economy have been undertaken. In the area of industrial policy, controls that had inhibited private initiative have been relaxed and new areas opened up to private sector participation. The programme of privatization of public enterprises has moved apace and progress has been made in removing subsidies as well as in rationalizing prices in a move towards a more market based economy. In the financial sector, significant developments include the establishment of a stock market, dismantling of controls on interest rates, deregulation of the commercial banking system, and adoption of measures aimed at improving the performance of the Government's financial institutions.

Similarly, there have been notable developments in the foreign trade sector. A unified exchange rate with full convertibility on the current account was instituted in 1993, while import restrictions were relaxed and tariffs reduced. As a consequence, there was a marked improvement in export performance, the balance-of-payments position strengthened and foreign exchange reserves rose to a comfortable level of nine months' imports. Inflation has also been reduced and a more conducive atmosphere has encouraged increased private participation in both industry and services.

However, these positive results have yet to have an impact on the overall growth of the economy. The main constraints are stagnation in agriculture and inability to raise resources to a sufficient level as reflected in the high fiscal deficit and the large resource gap between saving and investment. A shortage of power has also posed a serious constraint to industrial expansion and it could also harm the tourism industry by disrupting urban services.

The current Eighth Plan (1992-1997) attaches high importance to promoting broad-based agricultural growth and diversification and a major hydroelectric project that will soon be implemented is expected not only to meet the rising energy needs of a growing economy but also to generate a surplus for export. Measures aimed at greater domestic resource mobilization through tax reform and more effective resource management to control expenditures have been given special emphasis in the budget for the fiscal year 1994/95.

In Samoa, the 1994 budget statement contained important fiscal reforms. These included the introduction of a new value added tax and reduction of taxes on individual and corporate income with a view to, *inter alia*, creating a more conducive environment for private investment.

The reduction of a persistently high budgetary deficit is a major policy concern in Solomon Islands. Several measures introduced in the year envisaged corporatization and privatization of many commercial functions performed by the Government. A new Ministry of Development Planning was set up to evaluate development projects and to ensure that expenditure incurred in their implementation conformed to budget provisions.

In Vanuatu, customs duties and indirect taxes are the main source of revenue for the exchequer. The Government might wish to pay attention to the diversification of its revenue sources with a view to imparting greater flexibility to fiscal policy.

Pacific island countries

A total of 19 economies (including five least developed countries) or about a third of the membership of ESCAP is from the Pacific subregion. These economies differ among themselves in many ways, but they also share many common features. With the exception of Papua New Guinea, these economies are small in terms of their physical size and population. Most of these economies depend very heavily on aid to finance development, are extremely vulnerable to natural calamities and suffer from a variety of problems arising out of remoteness from major economic centres of the world. These and other problems confronted by Pacific island economies have been highlighted in various past issues of the *Survey*.

These countries will have to face a number of emerging issues in their development efforts. The unconditional budget aid, for example, to most independent island countries has ended and the competing demand for the limited aid resources from various claimants around the globe make it unlikely that such aid will be restored in the foreseeable future. Furthermore, the impact of the Uruguay Round on these economies still remains unclear. Of particular concern to many of these countries is the effect of the Round on the preferential trade arrangements that these countries have hitherto enjoyed, especially in agricultural commodities. The relevant agreements include Lomé IV and the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA), which give duty-free access to a significant portion of the exports of the Pacific island countries to a number of developed country markets.

Output growth

Cook Islands has had a remarkable record in economic performance with growth averaging over 6 per cent between 1991 and 1993, 11 per cent growth being recorded in 1992 alone (see table II.4). The pick up in construction activities, a sharp increase in offshore financial services and in tourism and related activities all contributed to the impressive growth recorded in 1992. This favourable result was possible even though agricultural output declined during the year. In 1993, the continued expansion of the transport, public administration and services sector compensated for a large drop in industrial output. In that year, the overall growth rate was only 1.2 per cent. The estimated growth in 1994 was about 6 per cent

Table II.4. Growth rates, 1991-1993. Selected Pacific island economies

(Percentage)

		Rates of growth			
		Gross domestic product	*Agriculture*	*Industry*	*Services*
Cook Islands	1991	7.0	-6.7	12.9	9.8
	1992	11.0	-8.3	24.0	13.7
	1993	1.2	0.2	-17.1	3.1
Fiji	1991	0.7	-0.4	5.9	-1.5
	1992	2.9	2.9	7.1	1.6
	1993	2.0	0.6	-5.2	5.0
	1994	3.2	7.4	4.9	1.4
Papua New Guinea	1991	9.5	-2.6	30.0	6.5
	1992	8.5	2.9	15.4	7.4
	1993	14.4	4.0	-2.7	33.1
Tonga	1991	5.4	9.8	-10.1	7.5
	1992	3.5	7.3	0.3	1.5
	1993	2.8	2.7	-1.0	2.1

Sources: See the source notes in table II.2.

Note: Data for 1994 are estimates.

principally from growth in the service sector. Tourism is expected to maintain the growth it has displayed in recent years, especially as new facilities become available.

The impressive growth performance achieved by Fiji during the late 1980s was not maintained after 1990. After recording almost 12 per cent growth in 1989, the growth averaged 2.6 per cent between 1990 and 1992. In 1993, it recorded a reduced growth of 2.0 per cent, substantially lower than 2.9 per cent achieved in 1992.

The industry sector, especially the extensive growth in the manufacturing sector following the introduction of tax-free factories, was largely responsible for higher growth in the late 1980s. Garment exports in fact have superseded gold as Fiji's third largest foreign exchange earner after tourism and sugar since 1989. In 1993, however, the industrial sector declined by 5.2 per cent compared with 7.1 per cent growth a year ago. The decline is attributed mainly to reduced construction activities, which more than offset increases in sugar production and garment exports. Sugar production increased by 3.9 per cent to 442,156 tons in 1993. Garment exports also bounced back to record a F$ 12 million increase for a total of F$ 129 million following a drop in earnings in 1992.

The service sector almost stagnated between 1991 and 1992 after recording an average growth of 10 per cent in 1989 and 1990. In 1993, the sector recorded a growth of 2.5 per cent. The performance of this sector is largely influenced by the tourism industry which is the largest foreign exchange earner for the country. Recession in source markets in 1991 negatively affected the tourism industry. Since then, the situation has improved and in 1993 tourist arrivals, particularly from Australia, Japan, New Zealand and the United States of America totalled a record 287,462 visitors, an increase of 3.2 per cent over the 1992 figure.

The latest estimates show a real GDP growth of 3.2 per cent in 1994, based on a record sugar production of 450,000 tons as well as increased tourist arrivals. Visitor arrivals for the first six months of 1994 showed an increase of 11.9 per cent, resulting in an increase of 14.1 per cent in tourism earnings compared with the same period last year.

After reaching 8.5 per cent annual growth in 1992 and 9.5 per cent in 1991, the economy of Papua New Guinea performed even better in 1993 with a growth performance of 14.4 per cent. Much of this strong growth is attributed to the strong performance of the service sector which grew by 33 per cent as a result of higher aggregate demand stemming from logging activity, increased producer incomes in the rural sector, and the real increase in government expenditure including the restoration programme in the North Solomons Province. Agricultural output also rose by 4 per cent with coffee and palm oil being the principal contributors. The production of logs also reached an all time high and recorded an increase of 48 per cent in 1993. The industry sector, however, contracted by 2.7 per cent following the completion of several major projects including the Kutubu oil project in June 1992. Even though the non-mining GDP growth especially from the construction and manufacturing activity related to new mining development is projected to record a rise, the economy on the whole most likely experienced a sharp deceleration in 1994 because of a major fall in petroleum output.

The Tongan economy performed relatively well in 1991 and 1992. In 1993, however, it recorded a reduced growth of 2.8 per cent mainly reflecting the effects of drought, but it has been forecast to rebound with a positive growth of 4.8 per cent in 1994.

The impetus to economic recovery in 1994 was expected to come from increased agricultural output, particularly squash and also from construction and tourism. The construction sector recorded a negative growth of 6.5 per cent in 1993 but was forecast to grow by 12.7 per cent in 1994, reflecting an upswing in investment in the economy.

The tourism industry has been largely responsible for the relatively high growth performance of the Guam economy in recent years. Available data indicate that before Guam was devastated by several typhoons in 1992, including typhoon Omar in August which caused damages estimated in millions, the economy was doing well. But the tourism numbers took a dive after the destruction by typhoon Omar. However, on the whole, total arrivals for 1992 numbered 876,742, an increase of 18.9 per cent over 1991 mainly owing to arrivals from January through August. Natural disaster in the form of a severe earthquake again struck Guam in August 1993 and adversely affected the tourism industry. Tourist arrivals in 1993 declined by over 10 per cent compared with the previous year. Guam's construction industry reached an all time high in 1991 when 2,535 permits valued at $853 million were issued. Much of the construction activity in 1991 was for residential and condominium projects. In 1993, the number of permits issued increased, but value declined by 7 per cent. As a result, the total number of persons employed in the construction industry declined by 15 per cent in December 1993 compared with the same month a year ago.

The performance of the Marshall Islands economy in recent years has been largely influenced by public expenditure which is dependent on funding from the United States under the Compact of Free Association entered into in 1986. Agriculture is dominated by the subsistence crops, with copra production been the main source of cash income.

The Marshall Islands economy was estimated to have recorded an increased growth of 5 per cent in 1993 which was far better than the 1.5 per cent average growth recorded during the period 1988 to 1992. The upsurge of economic activities in 1993 was due to increased construction, higher fisheries output and a recovery in agricultural production which was negatively affected by cyclones in 1992.

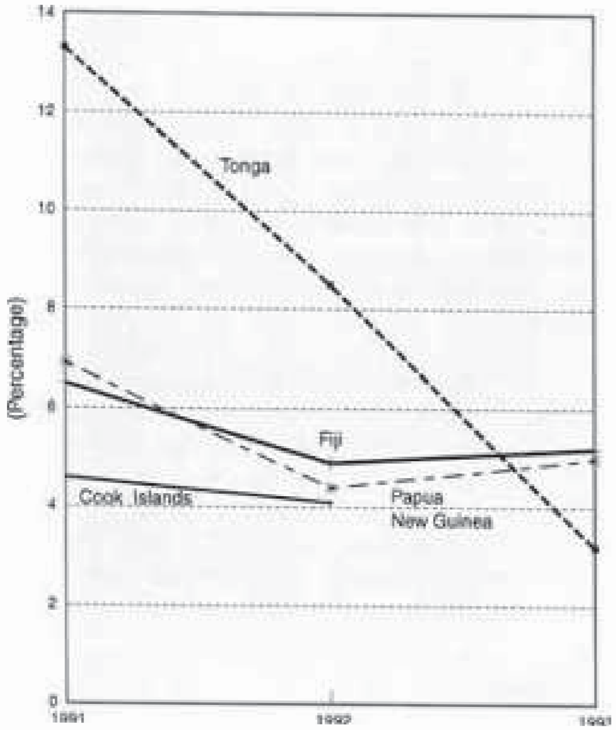
Inflation

In general, the price level in the Pacific subregion has been lower than in many other developing countries of the ESCAP region. The low inflation rates in the Pacific largely reflect the situation in major trading partners, especially Australia, New Zealand and the United States. Most island countries recorded less than 8 per cent inflation rates with Tonga recording the lowest rate of 3.2 per cent in 1993.

In Fiji, after increasing strongly in the first half of 1993, the inflation rate moderated in the second half but still showed an overall increase of 5.2 per cent for the year compared with 4.9 per cent in 1992 (figure II.2). The low inflation rate reflects the influence of low inflationary pressures in Fiji's trading partners as much of Fiji's inflation is imported. The downward trend continued in 1994 with the annual average inflation rate for the twelve months to August at 1.8 per cent.

The inflation in Papua New Guinea has moderated since 1991, the country recording an inflation rate of 5.0 per cent in 1993. The low inflation rate not only reflects the low prices in Australia and New Zealand, the major sources of imports, but also the Government's overall attempt to stabilize domestic prices through the maintenance of a stable exchange rate. The low level of inflation had

Figure II.2. Inflation rates,[a] 1991-1993. Selected Pacific island economies



Sources: See the source notes in table II.2.

[a] Refer to changes in consumer price index.

been maintained in early 1994 but the impact of the devaluation of the local currency in September 1994 is expected to contribute to an increase in price level in the last quarter of 1994 and into 1995.

The inflation rate in Tonga fell significantly to 3.2 per cent in 1993 from almost 9 per cent in 1992. The improvement in prices reflects the return of normal food supply conditions after the drought in 1992. The inflation rate in recent years has been higher than those prevailing in Tonga's major trading partners. Apart from the effects of drought, the rapid expansion in government expenditures leading to greater budgetary deficits in 1991 and 1992 contributed to the higher inflation rates. Expenditure restraining measures have had to be introduced to bring down the inflation rate. Inflation in Tonga was estimated to have remained unchanged at 3 per cent in 1994.

Food prices feature prominently in Guam's rate of inflation and much of its food is imported. In 1991, Guam recorded an inflation rate of 14.4 per cent which was the highest in recent years. The rate declined to 7.1 per cent in 1992, but picked up again to 11 per cent in 1993.

With the exception of 1992 when the inflation rate more than doubled to 10.3 per cent following the two cyclones which struck in late 1991 and early 1992, Marshall Islands has maintained price stability in recent years. In 1993, the inflation rate was estimated to have been 5 per cent, which was still higher than the average rate of 2.4 per cent recorded during the period 1989 to 1991.

Budgetary balance

Most Pacific island countries have succeeded in restraining the overall budget deficit to less than 10 per cent of GDP in recent years. However, it should be noted that in many of these countries, external grants play a major role in government revenues and hence overall budgetary balance gives an inaccurate picture of fiscal management.

Despite its attempts to have a balanced budget, several factors have contributed to persistent budget deficits in Fiji in recent years (table II.5). In general, expenditure has always been greater than originally estimated while revenue has not kept pace with the actual increases in expenditures. This was the case in 1993 when there was an overall deficit of 2 per cent of GDP compared to 1 per cent in 1992. Expenditure had to be increased to accommodate increases in wages and salaries as well as reconstruction needs following the destruction by cyclone Kina in January 1993. The shortfall in revenue was mainly caused by difficulties in the administration of the new value added tax.

The revised 1994 budget presented to parliament in April 1994 continued to emphasize the Government's commitment to a low deficit policy. The budget called for restraint in government expenditure and reform of the tax system to increase revenues. The anticipated deficit of 2.9 per cent of GDP was to be financed mainly from domestic sources. However, available figures suggest that the Government's fiscal operations in the first six months were expansionary compared with the same period last year. Total expenditure for the first half rose by 18 per cent over the same period last year while revenues rose by 14 per cent. The overall budget deficit increased to F$ 41 million during the first half of 1994 from F$ 25 million

Table II.5. Summary of macroeconomic indicators, 1990-1993. Selected Pacific island economies

(Percentage)

		1990	*1991*	*1992*	*1993*
Fiji	Savings/GDP	16.3	14.2	14.5	14.9
	Investment/GDP	17.1	13.3	13.3	16.7
	Budgetary balance/GDP	-2.2	-2.3	-1.0	-2.0
	Money supply growth	0.6	3.4	14.5	15.8
Papua New Guinea	Savings/GDP	21.7	16.9	23.4	27.8
	Investment/GDP	24.4	27.4	23.8	18.8
	Budgetary balance/GDP	-3.5	-1.9	-5.3	-3.3
	Money supply growth	-0.2	21.3	4.8	21.3
Tonga	Savings/GDP	-10.7	-16.6	-13.3	..
	Investment/GDP	18.7	17.8	18.1	..
	Budgetary balance/GDP	-1.3	-6.0	-4.2	1.8
	Money supply growth	29.8	15.2	-12.7	23.4

Sources: See the source notes in table II.3.

Note: Money supply refers to M_1.

during the same period in 1993. The deficit was mainly financed by the issue of treasury bills.

Papua New Guinea adopted a restrictive fiscal policy in light of decreasing external budgetary aid in 1991. In that year, the budget deficit was restricted to below 2 per cent of GDP. However, for the last three years since 1992, the Government appears to have adopted an expansionary stance.

The change of direction was prompted by the concern that the non-mining private sector, particularly the agricultural sector which supports about 90 per cent of the population, was not being adequately developed to generate enough jobs for the rapidly growing labour force. As a result, the budget deficit significantly increased to 5.3 per cent of GDP in 1992 but fell to 3.3 per cent in 1993. A large proportion of the deficit was financed from domestic sources.

In March 1994, the Government made adjustments to its policy by announcing a mini-budget which was prompted by the deterioration in the fiscal outlook, made worse by the falling oil prices. The main items were expenditure cuts of 54 million kina in local government and the village services schemes and new revenue measures especially concerning personal income tax and import duties aimed at raising 81 million kina.

Available data suggests that for the first three months of 1994, there was an overall deficit of 163.4 million kina compared with 60.4 million kina in the corresponding period in 1993. A balanced budget is being aimed for in 1995.

Tonga's fiscal policies during the 1980s emphasized balance on the current budget and the generation of small savings to finance the development budget. In 1990, the Government awarded salary and other benefits in the order of 34 per cent to the civil servants. As a result, a significant increase in the deficit emerged since no provisions were made for additional revenue measures to maintain fiscal balance. These were subsequently introduced in 1991 budget which included increases in import duties for selected items and a general rise in port and service tax. The Tongan Government was not successful in its attempts to restore budget balance in 1992, although the deficit which was financed largely from domestic sources, improved considerably from the level in 1991. The Government's efforts finally paid off when the budget recorded an overall surplus of 1.8 per cent of GDP in 1993. The 1994 budget reiterated commitment to expenditure restraint and a return to balance on the recurrent account.

In Cook Islands, there was a small budgetary deficit in 1990, which then deteriorated in 1991 to 65 per cent of GDP but improved again to 7.4 per cent of GDP in 1992. In 1993, the budget deficit was equivalent to 16 per cent of GDP which is explained by the increase in expenditure, especially capital expenditure. Current expenditure in 1993 was about 45 per cent of GDP, much the same as during the previous five years. This contrasts sharply with most other island countries where current expenditure usually contributes to the budget deficits. Much of the deficit has been financed through external borrowing which clearly explains why the country's external debt has almost increased five times from 22 per cent of GDP in 1990 to 100 per cent in 1993.

The combined government revenues in Guam for 1993 totalled $689.9 million which was an increase of 5.5 per cent over 1991. Much of the revenue, about 79 per cent, was from taxes. The combined expenditures for 1993 totalled $573.2 million which was an increase of 6.7 per cent from 1992. There was an overall surplus in the budget of $116.7 million. The Government of Guam spent about a third of total expenditure on education in 1993.

Marshall Islands recorded budget deficits in 1991 and 1992 following surpluses in the three preceding years. The deficit in 1992 was caused by an increase in total expenditure by 13 per cent while total revenue declined, mainly because of a fall in non-tax revenues and grants from the United States. The worrying trend is that current expenditure, especially on wages and salaries has increased steadily in recent years, rising by over 22 per cent since 1990. The budget deficit in 1992 was equivalent to 28 per cent of GDP compared with a deficit of 10 per cent of GDP in 1991.

The Central Asian republics

As discussed in the *1993 Survey*, the most defining characteristic of the macroeconomic scenarios in the Central Asian members of ESCAP, namely, Armenia, Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan since 1990 has been a steep decline in output in combination with extremely high inflation rates. Against this backdrop, policy priority has focused on devising and implementing fiscal, monetary and trade policies to promote both the short-run stabilization and the longer-run growth and restructuring of the economy. The institutional prerequisites to implement these policies effectively take time to be met. Nevertheless, there is a strong and understandable pressure to achieve quick results in terms of combating inflation and containing decline in output with a view to sustaining popular support for reforms. Reconciling this short-run need with the longer-run needs of economic restructuring and growth has posed a formidable challenge to the policy makers in the transitional economies in general and the Central Asian republics in particular. As with other transitional economies, the Central Asian republics have to address the problem of reshaping economic policy to achieve the objectives of stabilization simultaneously with major institutional and structural reforms encompassing, *inter alia*, price and trade liberalization, privatization and the creation of essential market economy infrastructure. Moreover, they have to contend with the challenging task of building entirely new institutions such as central banks and customs administration essential for national economic sovereignty.

Output growth

The general pattern of declining output reported in 1993 continues to be present in varying degrees across the countries under review.

The conflict between Armenia and Azerbaijan has adversely affected this process of stabilization and growth of both these economies. However, Armenia appears to have succeeded in limiting the fall in gross national product (GNP) and may have recorded a modest positive growth by the end of 1994, a notable performance considering that Armenia had experienced the deepest economic decline among all Central Asian republics in 1992 (see table II.6). Although still heavily dependent on imported food, Armenia also reported an increase in agricultural production during 1994 and a shift in agricultural product mix toward food.

Both the net material product (NMP) and the industrial output fell by an estimated 25 per cent in Azerbaijan during the first eight months of 1994. This represents a steeper decline than that experienced in 1993. With industry accounting for 51 per cent of the NMP (as of 1992), Azerbaijan is the most industrialized among these republics. Production in many industries, however, was geared to markets in the rest of the former Union of Soviet Socialist Republics. The disruption of inter-republic trade links clearly contributed significantly to the particularly pronounced fall in industrial output in Azerbaijan. Agricultural production also generally declined, although to a smaller extent, in the wake of a large fall in 1993. Grain output is estimated at 90 per cent of the 1993 level; part of this fall could be attributed to lower agricultural acreage caused by hostilities with Armenia.

Table II.6. Growth rates, 1991-1993. Central Asian republics

(Percentage)

		Rates of growth		
		Gross domestic product or net material product	*Gross agricultural output*	*Gross industrial output*
Armenia	1991	-11.4	11.0	-7.7
	1992	-46.0	-13.0	-52.5
	1993	-9.9	-5.0	-11.1
Azerbaijan	1991	-0.4	-	4.7
	1992	-28.1	-25.0	-24.0
	1993	-13.3	-17.0	-6.8
Kazakhstan	1991	-10.3	-8.0	-0.9
	1992	-14.2	1.0	-14.8
	1993	-12.8	-3.0	-16.1
Kyrgyzstan	1991	-5.2	-8.0	-0.3
	1992	-19.0	-5.0	-26.8
	1993	-17.4	-8.0	-24.2
Tajikistan	1991	-8.4	-10.0	-3.6
	1992	-31.0	-27.0	-24.3
	1993	-21.0	-2.0	-19.5
Turkmenistan	1991	-4.7	-2.0	4.8
	1992	-5.3	-9.0	-16.7
	1993	7.8	9.0	5.3
Uzbekistan	1991	-2.4	-5.0	1.5
	1992	-12.9	-6.0	-6.2
	1993	-3.5	-	-7.0

Sources: Economic Commission for Europe, *Economic Survey of Europe in 1993-1994* (United Nations publication, Sales No. E.94.II.E.1); and The Economist Intelligence Unit, *Georgia, Armenia, Azerbaijan, Kazakhstan, Central Asian Republics*, 4th quarter 1994 (London, Business International Limited, 1994).

Rich in natural resources and with the highest per capita income among the republics, Kazakhstan experienced the steepest fall in output along with the second highest inflation rate in the region during the January-August 1994 period. GDP was reported to have fallen by 30-35 per cent as compared with 10.3 per cent in 1991, 14.2 per cent in 1992 and 12.8 per cent in 1993. As of November 1994, industrial output was estimated to have been 28 per cent below the 1993 level. With agriculture and forestry accounting for 48 per cent of NMP, Kazakhstan is the only major grain exporter among the republics. In 1994, agricultural output declined as a result of disruption in input supplies and unfavourable climatic conditions.

In Kyrgyzstan output fell by 25 per cent during the first eleven months of 1994 as compared with a 17.4 per cent fall in 1993. This indicates that the economy is yet to turn around. Since the defence industry accounts for a significant proportion of Kyrgyzstan's industrial output, problems in converting these industries to civilian uses contributed to the poor industrial recovery in an important way. Another development that has made the transition process more difficult in 1994 was the decline in basic foods production, estimated at about 40 per cent.

Tajikistan recorded the highest output decline among the Central Asian republics during 1993. The decline continued through 1994. During the first nine months of that year, the industrial output fell by 25 per cent. Particularly hard hit was the consumer goods industry where production fell by 41 per cent with clear implications for the standard of living.

Turkmenistan which, along with Uzbekistan, has adopted the most cautious approach to the scope and speed of economic reforms also experienced a steep output decline in 1994. During January-August 1994, NMP and industrial production fell by 17 and 32 per cent respectively, as compared with some positive growth in 1993. The major shock to the industrial production in Turkmenistan came from the crisis in gas production caused by non-payment by two major importers: Ukraine and Georgia.

Over the January-August 1994 period, the NMP and industrial production in Uzbekistan fell by an estimated 8 and 1 per cent respectively. Production of consumer goods and agricultural output in fact increased by 4.4 and 12.4 per cent respectively. The output of grains was estimated to have increased by as much as 41 per cent reflecting the new policy emphasis on reducing dependence on imported grains and consequent switching of acreage from cotton, a major source of foreign exchange earnings.

Demand components

Any attempt to decompose the national output into its demand components in the Central Asian republics runs into a number of difficulties, both at conceptual and practical levels. In the national accounting system in the former Soviet Union, the concern was with the supply rather than the demand side of the production process because the level and the composition of production were based on administrative planning rather than on demand patterns articulated through the market choices. Statistical systems for trade, national accounts and sectoral outputs diverged considerably from the standard, internationally accepted concepts and formats, complicating the task of generating comparable time-series data. Economic volatility and institutional transition also make the task of systematic data collection a particularly difficult one. A number of international organizations within and outside the United Nations system are now helping some of these countries to develop new statistical information systems that reflect the needs of market-based decision-making and conform to standard international practices. Pending the availability of data generated through the use of such reformed methodologies and systems, due caution needs to be exercised in interpreting the available data.

Recent data indicate that consumption (private and public) accounts for roughly 80 per cent of the net material product in most Central Asian republics. Although consumption in recent years cannot be precisely determined, there is indirect evidence that suggests that the declining trend in real private consumption in most of these countries has continued in 1994. Thus, in Kazakhstan, over the period January to November 1994, the index of nominal personal expenditure on goods and services went up to 619 as compared with an increase in the consumer price index to 699, implying a fall in real consumption. Similar estimates, admittedly crude, for Turkmenistan and Armenia also show a fall in real private consumption. Such a decline in real consumption in most of these countries is also consistent with the sharp decline in the retail sales by the officially registered enterprises.

There is little hard data that would indicate the source or magnitude of private savings in the Central Asian republics. Until very recently, many of the motives for private saving such as planning for retirement, acquisition of real estate or paying for the future education of children did not operate in these countries the way they do in market economies. In a sense, private saving is a new phenomenon in these countries. Against the backdrop of very high inflation and a nascent system of financial intermediation, it is unlikely that these economies have generated private saving on any significant scale. It has, however, been speculated that high inflation and exchange rate uncertainty might have led to some capital flight, although it is not possible to document the magnitude of such transfers.

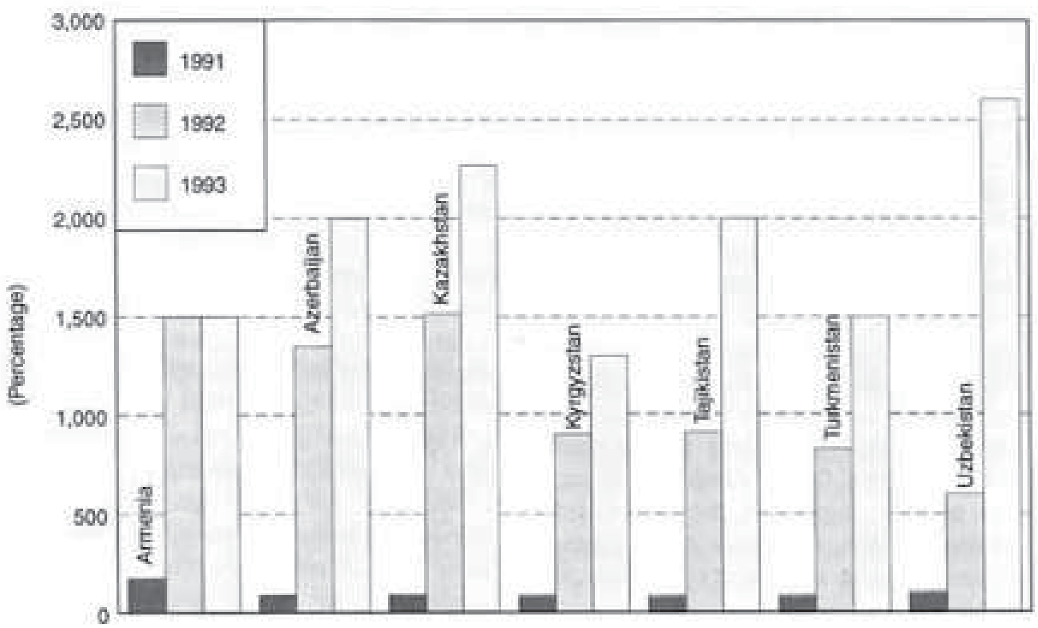
While real consumption has fallen in most cases, it would appear that it was investment that bore the major brunt of the steep decline in real aggregate expenditures. Most of the investment activities in these countries continue to take place in the public sector. During 1994, capital investment, critically important for achieving economic restructuring, suffered a serious set-back in all countries except Turkmenistan where the fall in capital expenditure was less serious. Turkmenistan's ability to prevent a sharp fall in capital expenditure in the short run can be explained by the continued regulatory control of investment activities and a more cautious approach to structural reforms. Social investment expenditures on residential construction, schools and hospitals also declined in these countries.

Given the dominant role of trade among members of the Commonwealth of Independent States (CIS) in the external economic relations of the Central Asian republics and the severe disruptions following the dissolution of the Soviet Union, the foreign trade sector was clearly a source of strong negative shock to these economies. Although it is difficult to come up with firm figures on the volume, value and direction of intra-CIS trade, it is generally accepted that such trade contracted across the region. The introduction of new national currencies, exchange rate volatility and the absence of a multilateral payments mechanism led to increasing reliance on bilateral trade, sometimes of a barter type. During 1994, even many of these bilateral agreements did not actually materialize because of supply constraints and the breakdown of payments mechanisms. Given the integrated character of the economic structures of these economies, a revival of the intra-CIS trade is likely to play an important "pump-priming" role in the short-run recovery of these economies. In October 1994, an agreement was signed among the CIS republics on the creation of a payments union which would provide for mutual convertibility of currencies and for both bilateral and multilateral payments mechanisms.

Inflation

Extremely high inflation continues to be the dominant feature of the macroeconomic scenes in these countries (figure II.3). Even in countries such as Armenia where performance on the production side shows significant improvement, high inflation remains a major impediment to the processes of economic recovery and growth. The freeing of prices in economies where large enterprises enjoy substantial market power, the upward revision of administered prices, the supply bottlenecks created by disruption in the input delivery networks, and the continuation of large fiscal deficits financed principally by borrowing from the central banks have all played important roles in creating and sustaining a highly inflationary situation. Also important in the inflationary process was an inherited economic structure characterized by the dominance of raw materials and defence industries and an insufficient development of the consumer goods sector.

Figure II.3. Inflation rates,[a] 1991-1993. Central Asian republics



Sources: See the source notes in table II.6.

[a] Refer to changes in consumer price index.

During 1994, Armenia recovered significantly from the hyper-inflationary situation that characterized its economy in 1992-1993. Since the middle of 1994, the price rise has been relatively restrained; retail prices increased by a monthly rate of only 1 per cent as compared with a 26 per cent increase in January 1994. This reflects a more restrictive regime of budgetary and credit policies pursued by the Government and the central bank as well as an increased supply of goods in the market. However, there have been indications of accelerating inflation since September 1994.

During 1994, the inflationary situation in Azerbaijan remained serious: the consumer price index rose by 325 per cent from January to October 1994, fuelled by a large budgetary deficit and a seven-fold increase in the money supply.

The consumer price inflation in Kazakhstan for 1993 was estimated at 2265 per cent. For 1994, available data indicate an increase in retail prices of 699 per cent over the period January to November. A specific feature of the inflationary situation in Kazakhstan was the greater escalation in producers' prices than in retail prices. This seems to underscore the importance of cost and institutional factors in the inflationary process. In fact, demand factors such as a budgetary deficit and credit expansion were moderate during the year against the backdrop of a budgetary policy which aimed at reducing the overall budgetary deficit as a percentage of GDP and imposing limits on the extent of bank financing of such a deficit as well as on all budgetary transfers and subsidies.

Among the Central Asian republics, perhaps the best success in the fight against inflation has been achieved by Kyrgyzstan in 1994. There was a dramatic slowing down of the inflationary trend with the monthly inflation rate dipping to 2.5 per cent in July and August 1994. Tighter fiscal and monetary control contributed to this process: the budgetary deficit was kept within a 7-8 per cent range of the GDP and the overall credit expansion was modest by the standard of other Central Asian republics. However, the policies that produced significant results in fighting inflation may also have contributed to the deepening of economic contraction in Kyrgyzstan during 1994.

In Tajikistan which had a consumer price inflation of some 2000 per cent in 1993, inflation appeared to have significantly slowed down in 1994. The fact that Tajikistan ran a small budget surplus in 1994 might have helped in the process. However, it may be pointed out that Tajikistan, as the sole Central Asian republic member of the rouble zone, exercises only limited control over its money supply through its budget. The other possible partial explanations for the deceleration in inflation in Tajikistan include the exchange of old Russian roubles for the new in January 1994, the temporary freezing of bank deposits and the imposition of price control on ten basic consumer items.

There was a quantum jump in consumer prices to over 400 per cent in Turkmenistan in November 1993 largely as a result of the liberalization of food prices. Over the January-August 1994 period, retail prices increased by an estimated 366 per cent with monthly inflation rates sometimes assuming hyper-inflationary proportions. Such high inflation was fueled in no small measure by a heavy budget deficit financed through credit expansion. However, inflation in Turkmenistan was perhaps less painful than in other Central Asian republics because Turkmenistan still retains extensive social safety nets.

While Uzbekistan performed reasonably well on the production side in 1994, retail prices increased by 158 per cent from January 1994 to September 1994, although inflation seems to have moderated from July 1994 onward. The major source of inflation in the early part of the year was credit expansion. Since July 1994, however, the introduction of new currency (som), a more restrictive monetary policy, a moderate budget deficit and an increased supply of goods and services have all helped to moderate the inflationary pressure in Uzbekistan.

Policy responses

While the scope and the speed of economic reforms have varied substantially across the Central Asian republics, they have all had the common experience of declining output and high inflation, as noted before. Under these adverse macroeconomic conditions, the policy focus should rightly concentrate on stabilization measures aimed at containing inflation through the adoption of tighter fiscal and monetary policies. Kyrgyzstan and Kazakhstan were the first among the Central Asian republics to cooperate with the International Monetary Fund (IMF) in designing and implementing economic policies with strong stabilization components.

Since financing of the budgetary deficit by the banking system is incompatible with their goal of stabilization, some of these countries, such as Kazakhstan and Uzbekistan, announced specific plans to use treasury bills to finance a specified proportion of the budgetary deficit. The success of such relatively non-inflationary financing clearly hinges on controlling inflation without which these new financial instruments would not offer attractive channels for domestic savers. Unless appropriate money and capital markets develop quickly, the Governments may be tempted to force these bills on the banking system, thus leading to monetary expansion. Despite substantial increases in the nominal interest rate in most of these countries, the real interest rate still remains largely negative, implying a low cost of debt-financing of the budgetary deficit. However, as inflation is brought under control, gradually leading to positive real interest rates, the cost of servicing the public debt would go up with obvious implications for the budget deficit. The thrust of the policy actions should, therefore, be directed at narrowing the gap between budgetary revenues and expenditures.

On the tax side of the budgetary process, most of these countries have made major progress. The multiplicity of turn-over taxes has been replaced with value added tax in combination with excise taxes. Moreover, business and personal income taxes have been streamlined in the context of emerging market-oriented economies. In practice, the revenue potential of these measures was not realized because of a number of adverse conditions: shrinkage in the revenue base reflecting the depressed state of these economies, the negative impact of inflation on the real value of tax proceeds, increased transactions in cash making tax collection more difficult, and tax evasion. Looming large over the budgetary processes in all these countries is the question of how to replace the substantial transfers from the former Soviet Union budget which in some cases made up 30 per cent of the budgetary revenue in the past.

On the expenditure side, the state-owned enterprises continue to drain off scarce budgetary resources. In Armenia, for instance, net lending to the state-owned enterprises accounting for 17 per cent of the GDP went up further in 1994, offsetting the impact of the reduction of real wages of government employees and the removal or reduction of explicit and implicit subsidies. This has followed from the 1992 policy decision to provide loans to the state-owned enterprises at subsidized interest rates through the budget rather than through the banking system. Increased budgetary transfers to the state-owned enterprises have been necessitated in all these republics in part by the mounting enterprise arrears, that is, their indebtedness to each other and to the banks. From January to August 1994, these arrears increased 1.5 times in Azerbaijan, 3 times in Tajikistan, Kyrgyzstan and Uzbekistan, 6-7 times in Kazakhstan and 40 times in Armenia. These experiences underscore the importance from a budgetary point of view of the need for a speedy resolution of the issues pertaining to the privatization and restructuring of the state-owned enterprises. As long as the state-owned enterprises remain government responsibility, drainage of budgetary resources will continue.

In many transitional economies, the problem of bringing social expenditures under control remains a particularly difficult one. The countries under review all inherited quite elaborate systems of social care and there is a strong pressure to defend the standard of living guaranteed by the pre-existing systems. In the context of restructuring and marketization of these economies, issues of unemployment allowances, retraining of the labour force etc., have taken on new importance. The social expenditures are considered essential to sustain popular support for economic reforms currently underway. Reflecting this, the 1994 economic program in Kazakhstan listed "social market economy" as one of its goals. When Armenia raised prices as part of its price reform programme, it also decreed wage/pension increases for public sector employees stoking up an already serious inflationary situation. How to reconcile the need to avoid a significant erosion in the standard of living with the need to control budgetary expenditures poses a formidable challenge to the policy makers in all these countries. Although it is important that the policy focus shifts from the current universal to more targeted welfare, working out the specific modalities for such a transition constitutes a challenging task.

Notwithstanding these difficulties, some of these countries have achieved notable successes in moving toward greater budgetary discipline. Kazakhstan set a target to reduce the overall deficit to around 6 per cent of GDP with domestic bank financing of such a deficit limited to 4 per cent of the GDP in 1993. The programme outlined measures to broaden the tax base and increase the revenue. The programme also called for a prudent wage policy and for budgetary transfers and subsidies to be limited to 5.1 per cent of GDP. The actual deficit in 1993 was estimated to have been at 2.9 per cent, indicating that the deficit target had in fact been exceeded. Kyrgyzstan also achieved notable success in containing the deficit.

The linkage between budgetary deficit and inflation is determined largely by the nature of the banking/monetary system in a country. All the republics have started implementing a two-tier banking system, under which the central bank focuses on the stability of currency and prices while the commercial banks assume responsibility for financial intermediation, i.e., mobilization and allocation of savings among competing uses. A critical element in a successful system is the independence of the central bank in shaping the monetary, exchange rate and credit policies.

In Kyrgyzstan, the relative stability of the new national currency (som) has been attributed to the central bank's assertion of independence in the matters of currency emission, credit issuance and the management of the exchange rate, and to its ability to pursue tight monetary and credit policies to slow down inflation significantly. It is yet to be seen to what extent central banks elsewhere can counteract the present tendencies toward more or less automatic monetization of budgetary deficits.

Although there has been a significant increase in the number of privately-owned commercial banks in all these countries, this by itself does not signify the emergence, as yet, of a competitive, market-oriented banking system. Financial resources continue to be channelled largely through a few state-owned banks, usually of a sectoral character, that rely heavily on the central banks for their own resource requirements. They are yet to develop any significant capacity to mobilize private savings from households and from the existing and the emerging businesses. The creation of such capacity has to be given due priority in the development of financial infrastructure in these countries. In the current state of the financial system and particularly in the context of the prevailing inflationary situation, sources of long-term investible resources are extremely limited, with the commercial banks extending largely short-term loans. Concerns with this issue are reflected in the recent establishment in Kazakhstan of a development bank that has been given the responsibility for targeting and ensuring the efficient use of long-term credit as well as implementing projects it finances. Another aspect of financial sector infrastructure that calls for urgent policy attention is the development of capital markets in these economies.

In a well-functioning market economy, it is the interest rate rather than administrative fiats that largely determine the allocation of resources among competing uses. Most of the countries under review have moved toward greater reliance on the interest rate for allocation purposes. The key to this process is the willingness to let the market forces determine the interest-rate structure that would reflect the scarcity value of capital resources in the economy. The National Bank of Kazakhstan in 1993 moved away from the extension of loans at interest rates below its own official refinance rate. In March 1994, Uzbekistan issued a decree to raise the discount rate and restrict the extension of soft loans. In Kyrgyzstan also, the central bank's discount rate was gradually increased reaching the level of 160 per cent at the end of 1993 which, against the backdrop of a deceleration in inflation, implied a positive real interest rate. In most other countries, real interest rates still remain largely negative.

Stabilizing the value of new national currencies both internally and externally remains one of the most challenging tasks facing these countries. As regards the external value of their currencies, they have (except Tajikistan which stays in the rouble zone), by and large, opted for a managed float type of exchange rate regime in which exchange rates are determined on the basis of periodic foreign currency auctions. It would appear that all these countries set the initial exchange rates for their new currencies at highly overvalued levels. These initial exchange rates could not be sustained as the countries did not have the massive foreign exchange reserves needed to defend their exchange rates in the face of high inflation rates and, in some cases balance-of-payments deficits. Depreciation of the currencies in nominal terms has continued with the possible exceptions of Kazakhstan and Kyrgyzstan where some stabilization of the exchange rates appeared to have taken place in 1994. By and large, the foreign exchange markets in most republics are still very thin and in some cases periodic auctions had to be put on hold because of inadequate reserves. Although the nominal exchange rates have generally depreciated, it should be noted that in the highly inflationary situation prevailing in these countries during 1994, there has been appreciation in real terms. The possible implications of such a development for the international competitiveness of these economies deserve closer attention.

South Asia

The South Asian countries have been undertaking active macroeconomic reforms to enhance economic growth and achieve stabilization for a number of years. Although it is still early to make any definitive assessment, it seems that the reform programmes have started to yield positive results. The combined GDP growth rate of India, Islamic Republic of Iran, Pakistan and Sri Lanka was estimated to be 5.1 per cent in 1994 as compared with 4.3 per cent in 1993. The industrial sectors, in general, performed well. Growth in services output in most cases has remained buoyant; that of agricultural output has been uneven, often caused by variations in weather conditions.

Stabilization policies with regard to the control of inflation and the reduction of fiscal deficits have had mixed successes. On the inflation front, achievements in 1994 were encouraging. The rate of inflation is estimated to have increased in India and Pakistan, but the increases were small. Although demand management policies have been actively used to contain inflation, cost push factors, especially increases in administered prices as a part of price reforms, have contributed to inflationary tendencies. This phenomenon, observed in all the South Asian countries in varying degrees, has been particularly important in the persistence of the high inflation rate in the Islamic Republic of Iran which started vigorous price and exchange rate reforms only recently.

During the past year, a reduction in the budgetary deficit remained a major policy target in all countries. Among the four South Asian countries, the Islamic Republic of Iran appears to have achieved notable success in this respect. Expenditure overruns and/or revenue shortfalls have caused rather erratic performance in all the other countries.

Fiscal deficits have traditionally been a major source of liquidity creation in the South Asian countries. However, in recent years a new dimension has been added by sharp increases in capital flow. Substantial foreign capital inflow in the form of foreign direct investment and portfolio capital has been experienced in South Asian countries in response to liberalized financial policies. In some cases, these inflows, especially portfolio capital, led to increases in foreign exchange reserves and the money supply, generating inflationary pressures. This phenomenon calls for innovative use of policy instruments to neutralize the inflationary impact of short-term capital inflows.

Output growth

In India there was a continuous improvement in economic performance in the 1992-1994 period from the lackluster performance of 1991 when GDP increased by just over 1 per cent (table II.7). The improved performance can be attributed both to a variety of reform measures undertaken since then and continuous good weather conditions. The growth rate of GDP in 1992-1993 has been around 4 per cent; it was estimated to have increased further to 5.4 per cent in 1994.

Agricultural production in 1994, estimated to be 3.5 per cent, was a notable improvement over the previous year. Foodgrain production was likely to go up by 3.8 per cent. Government procurement and stocks of foodgrain have also been substantially higher in 1994 allowing considerable flexibility to the government management of food supplies.

Industrial output which suffered a set-back in 1991 slowly recovered over time and was expected to record a healthy growth of 6.5 per cent in 1994, compared with 3.3 per cent in 1993. A rapid expansion of public expenditure along with increases in industrial and financial activities had a favourable impact on the growth of the service sector whose share increased from 36 per cent in 1980s to 41.6 per cent in 1994. The growth rate of the services sector for that year was estimated to be 6 per cent. Infrastructure continued its general upward trend in 1994. However, despite several measures to augment capacity, the power supply could not match the increased demand from industrial activities.

In the Islamic Republic of Iran the pace of economic reforms continued despite unfavourable external conditions. The GDP growth rate of 1994, estimated at 4.9 per cent, was similar to the preceding two years.

The oil sector commands a significant weight in the economy of the Islamic Republic of Iran. During 1993, the production of crude oil in the Islamic Republic of Iran increased by 5.8 per cent which was less than in the previous year. The agriculture sector grew favourably during 1993 with an estimated increase of 5.5 per cent. There were considerable increases in rice and wheat production. In 1993, industries passed through a phase of adjustments consequent to the economic reform measures and industrial performance was sluggish. Value added in the industry sector grew by only 2.9 per cent which was lower than in the previous year. The electricity sector during 1993 performed well as

Table II.7. Growth rates, 1991-1994. Selected South Asian economies

(Percentage)

		Rates of growth			
		Gross domestic product	*Agriculture*	*Industry*	*Services*
India	1991	1.2	-1.4	-0.0	4.3
	1992	4.0	5.0	2.2	4.5
	1993	3.8	2.3	3.3	5.2
	1994	5.4	3.5	6.5	6.0
Iran (Islamic Republic of)	1991	10.9	5.1	14.2	11.3
	1992	5.5	7.4	3.1	7.5
	1993	5.0	5.5	2.9	7.7
	1994	4.9	..	..	..
Pakistan	1991	5.6	5.0	6.9	5.2
	1992	7.7	9.5	7.7	6.8
	1993	2.3	-5.3	5.6	4.6
	1994	4.0	2.6	5.4	3.8
Sri Lanka	1991	4.8	1.8	4.4	5.6
	1992	4.4	-1.8	7.5	5.4
	1993	6.9	4.9	7.0	6.3
	1994	5.9	3.9	7.5	6.2

Sources: See the source notes in table II.2.

Note: Data for 1994 are estimates.

generation increased. The improvement in the generation of electricity was mainly due to the increased capacity of the power plants, the expansion of the electricity transmission network and improvements in fuel delivery at the power stations.

GDP growth in Pakistan was recorded at 4 per cent in 1993/94 showing some improvement over 1992/93 when GDP growth fell to 2.3 per cent. Agriculture occupies an important position in the economy of Pakistan. The major cause of the sluggish growth in 1993 and 1994 was the poor performance of the agricultural sector owing to bad weather conditions. In particular, cotton output fell negatively affecting the growth of agriculture and also having a downstream impact on the other sectors.

During the fiscal year 1993/94 industrial investment in Pakistan increased by over 15 per cent. Liberalized policies attracted substantial foreign investment boosting industrial activities. Despite a decline in cotton ginning industries, the overall industrial sector was estimated to have grown by 5.4 per cent, aided by a healthy growth in other large-scale industries. Services output grew by 3.8 per cent, which was lower than in the previous year. Growth in trade services has been low although financial services grew at a much faster rate. Electricity and gas, after performing well for the past three years, slipped as hydroelectricity production declined as scant rains caused less water to accumulate in the dams. Gas distribution, however, grew over 9 per cent, thus reflecting a combined growth rate of electricity and gas at 6.1 per cent.

In Sri Lanka, the growth rate of GDP was estimated to be about 6 per cent in 1994. This was somewhat lower than in 1993 when, aided by a strong agricultural performance, GDP increased by 6.9 per cent. Similar to other South Asian countries, the contribution of agriculture to the growth performance continues to be significant, its share in 1994 being 20 per cent of GDP. Agriculture was estimated to register a growth rate of 3.9 per cent in 1994 compared with 4.9 per cent in 1993.

Industrial output which grew by 7 per cent in 1993 was likely to maintain a similar tempo in 1994. There has been some structural change in the country's industrial sector. The garments and apparel industry which was instrumental in increasing growth in industrial export in recent years is still showing a strong performance, but there are signs of a shift towards ceramics, food processing, leather products, light engineering and electronics. The service sector as a whole has shown strong growth in recent years and effectively complemented the increasing level of activity in the industrial sector. The introduction of new financial instruments and the all-round development of banking infrastructure started with vigour in 1993 and continued in 1994. In 1994, finance and insurance services were likely to register a growth of 9.1 per cent, whereas wholesale and retail trade was estimated to increase by 7.1 per cent.

Demand components

In 1993, owing to increases in both household and private corporate savings, gross domestic savings in India as percentage of GDP was expected to improve further to 24.3 per cent from an already high 22.3 per cent in 1992 (table II.8). However, public sector savings were likely to deteriorate because of expenditure overruns. Gross domestic investment has remained almost stagnant at around 24 per cent of GDP since 1991. Both public and private investment have been sluggish. Public investment slowed down as the Government resorted to expenditure reduction to meet fiscal targets. The private sector remained largely engaged in adjusting its activities in response to economic reform measures and did not come up with any ambitious expansion plan.

Expenditure overruns on food and fertilizer subsidies, defence, and transfers to states and public enterprises led to a fiscal deficit of 7.5 per cent of GDP in 1993 which exceeded the target of 4.7 per cent. The phenomenon was likely to be repeated in 1994 when the deficit was targeted at 6 per cent of GDP. The growth rate of the money supply accelerated in 1993 owing to sharp increases in primary liquidity caused by a phenomenal growth in foreign assets by 115.3 per cent. The inflow of foreign capital increased in response to liberalized policies on foreign investment. A major part of the inflow has been in the form of portfolio investment

Table II.8. Summary of macroeconomic indicators, 1990-1993. Selected South Asian economies

(Percentage)

		1990	*1991*	*1992*	*1993*
India	Savings/GDP	24.0	23.1	22.3	24.3
	Investment/GDP	27.3	24.2	24.5	24.4
	Budgetary balance/GDP[a]	–8.4	–5.9	–5.7	–7.5
	Money supply growth	14.3	22.6	8.4	21.1
Iran (Islamic Republic of)	Savings/GDP	24.8	28.6	30.0	..
	Investment/GDP	28.6	26.0	32.6	..
	Budgetary balance/GDP[a]	–1.1	–2.2	–1.6	–0.6
	Money supply growth	24.6	21.8	20.0	36.9
Pakistan	Savings/GDP	11.8	12.7	16.7	13.4
	Investment/GDP	18.9	18.9	20.2	20.7
	Budgetary balance/GDP	–7.1	–6.3	–6.4	–7.9[a]
	Money supply growth	17.3	20.2	21.5	..
Sri Lanka	Savings/GDP	13.2	12.8	15.0	16.1
	Investment/GDP	21.2	22.9	24.3	25.7
	Budgetary balance/GDP	–7.9	–9.6	–5.4	–8.1[a]
	Money supply growth	12.8	17.7	7.4	18.6

Sources: See the source notes in table II.3.

Note: Money supply refers to M_1.

[a] Excluding grants.

which contributed to increases in foreign assets. The accelerated pace of monetary expansion witnessed during the second half of 1993 has continued in 1994 when the broad money supply (M_3) was expected to grow by 16.5 per cent, which, however, will be substantially lower than in 1993.

In 1993, despite expansion in the volume of fiscal operations, the budget deficit of the Islamic Republic of Iran declined. Total government revenue increased steeply. During 1993 devaluation took place and revenues raised from the domestic sale of foreign exchange received from the export of oil provided additional financial resources to the Government. Along with a rise in oil revenues the Government continued its attempts to raise tax revenues with some success. The share of direct taxes in the total tax revenue increased substantially in 1993 showing improvements in direct tax administration. The increase in revenues more than compensated for the substantial rise in government expenditure. In 1994, the revenue buoyancy was expected to be higher with a further fall in the deficit. The money supply (M_1) in 1993 grew substantially by 36.9 per cent compared with 20 per cent in 1992, partly reflecting the increased demand for local currency caused by devaluation.

In Pakistan, in spite of an increase of industrial investment, fixed capital formation during the fiscal year 1993/94 stagnated mainly because of reduced investment in services. Gross domestic investment in the year has been provisionally estimated at 19.9 per cent of GDP, practically the same as in the previous year. In recent years, the share of the private sector in investment has tended to increase as a result of deregulation and privatization processes.

It is estimated that the overall fiscal deficit was reduced from 7.9 per cent of GDP during the 1992/93 fiscal year to 5.9 per cent of GDP in the subsequent year. The Government tried to achieve fiscal discipline by enforcing tax compliance as well as keeping a check on expenditure by reducing subsidies and other unproductive expenses and improving efficiency in resource utilization. The budget for 1994/95 contained several new measures to reduce the overall deficit to 4.0 per cent of GDP.

With respect to base money creation, the effect of a reduction in the budget deficit has been partially neutralized by a substantial increase in foreign reserves and a corresponding increase in net foreign assets. The growth in money supply, therefore, has not declined much. The estimated growth of M_2 during the fiscal year 1993/94 was 17 per cent.

In Sri Lanka the investment-GDP ratio which was around 21 per cent in 1989 increased to about 26 per cent in 1993. This growth has been facilitated by increases in foreign direct investment which continued in the first half of 1994. The investment to GDP ratio during the whole year was likely to be at the same level as in 1993.

An increase in current expenditure exerted excessive demands on the Government's budgetary resources. Although the Government took a decision to cut public investment, halted new construction and deferred purchases, the budget deficit was likely to be 8.3 per cent of GDP in 1994, higher than targeted. In 1994, narrow money (M_1) was expected to grow by 14 per cent and broad money by 20 per cent.

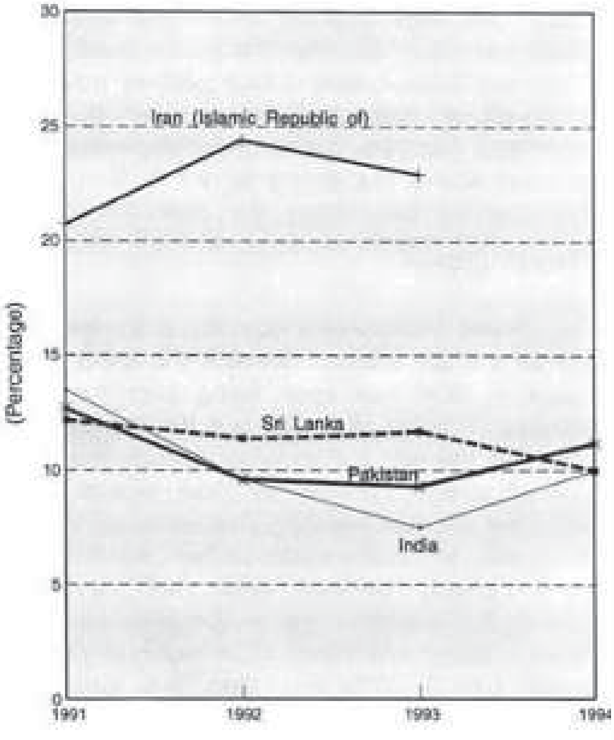
Inflation

In India, the money supply rose rapidly as a consequence of increases in the net capital inflow in both 1993 and 1994 and exerted upward pressure on prices. The annual rate of inflation stood at 11.1 per cent at the end of July 1994. This rate was much higher than that of a year ago and signified the lagged effect of money on excess demand and prices. During the current year the Government undertook various supply side measures to curb the rising trend in prices. These included augmenting supply through liberal imports of essential consumer goods and strengthening the public distribution system to utilize the food stock effectively. With these policies in place, the inflation rate was estimated to be contained at 10 per cent in 1994 (figure II.4).

In the Islamic Republic of Iran the general price level continued to be under pressure in 1993. The exchange rate devaluation, increases in administered prices and rapid liquidity growth were among the factors responsible for price escalation. The increase in the consumer price index was 22.9 per cent which was marginally lower than in 1992 because of smaller increases in food prices.

In Pakistan the rate of inflation during the fiscal year 1993/94 reached double-digit figures. The Government increased a number of administered prices in April 1993 and August 1994. As a result, the annual increase of CPI was recorded at a level of 11.2 per cent. But for a number of

Figure II.4. Inflation rates,[a] 1991-1994. Selected South Asian economies



Sources: See the source notes in table II.2.

[a] Refer to changes in consumer price index.

demand management measures consisting of a tight monetary policy, lower borrowing for budgetary purposes, a check on credit expansion and interest rate hikes, price rises would have been greater.

In Sri Lanka, the annual rate of inflation in 1994, measured by changes in the Colombo Consumer Price Index, was expected to be 10 per cent indicating a reduction from 11.7 per cent recorded in 1993. This reduction is partly the result of a downward adjustment of a number of administered prices and a reduction of import duties on selected basic food items. Current inflationary pressure in Sri Lanka is attributable to both cost push and demand pull factors. Those included upward wage adjustments of employees of both private and public sectors, periodic scarcities of a number of food items and increases in current expenditure by the public sector.

Policy responses

The recent thrust of economic policies in South Asia has been on macroeconomic reforms. The reform measures aimed at enhancing growth rates, controlling inflation, and achieving sustainable internal and external balance. The above discussion provides an indication of the overall impact of those measures. Some recent developments in policy making in support of economic reforms are highlighted below.

In India, the momentum of liberalization and of deregulation was sustained. Except for fourteen industries deemed strategic on defence, health and safety, and environment considerations, industrial licenses have been abolished. Restrictions on investment and expansion of the large corporate houses have been discontinued. The entry of foreign investment and the import of foreign technology were liberalized with automatic approval of foreign investment up to 51 per cent of equity in 35 priority industries. Even in sectors traditionally reserved for the public sector (telcommunications, energy and postal services), the Government has taken a more liberal stance towards private investment, including foreign investment. Long the domain of the public sector, private investment in power is now unrestricted with up to 100 per cent foreign equity. To attract foreign capital in the power sector, a guaranteed rate of return on investment has been promised by the Government. The Indian rupee has already been made fully convertible on the trade account, and has been made almost fully convertible on the capital account for non-residents who can now open and operate foreign currency accounts more freely. Maximum import duties have been further reduced from 150 per cent in 1991 to 25 per cent in 1994 with lower rates (0-20 per cent) for export-related capital goods and power and fertilizer projects.

In the Islamic Republic of Iran, measures were taken to facilitate new investment in the industrial sector. Among them were the elimination of red tape in issuing industrial permits, the reduction of direct involvement by the Government in production, and the privatization of public and nationalized industries.

Under financial liberalization policies the banks were allowed to extend financial facilities without any restriction. Meanwhile the obligation of the commercial banks in purchasing new bonds was lifted in 1993. These policies have increased the role of commercial banks in the mobilization and allocation of resources on the basis of commercial criteria.

In Pakistan a prominent fiscal measure in the last budget has been the expanded coverage of general sales tax (GST) scheme. The scheme now encompasses an additional 277 items of which 108 items are imported and 169 produced domestically. A three-year tariff reform programme has been launched. Maximum duty has been slashed from 92 per cent to 72 per cent compared with 225 per cent in 1988.

As a major step towards financial sector reform, interest rates in Pakistan were raised for all concessional borrowings. This action removed the subsidy on government directed loans and the real interest rates for those loans became positive for the first time in decades. To reduce the volume of directed credit, the financing of public transport schemes by the banks was discontinued from October 1993.

Pakistan has been encouraging private sector participation in industrial activities. A new dimension is the incentive package offered by the State to the private sector in electricity generation where a 25 per cent rate of return on capital investment has been guaranteed. This proposal has received a strong response from foreign investors.

In Sri Lanka, the fiscal incentives provided for increasing industrial activities and exports have been streamlined. From early 1994 additional income tax concessions were provided to new and existing export undertakings. However, the granting of tax holidays has been ended and replaced by a proportional tax rate for a 20-year period. All exporters of non-traditional products of specific services which were taxed at higher rates will also be eligible for the reduced rate of 15 per cent for a period of 20 years.

South-East Asia

The countries in South-East Asia, with the only exception of Brunei Darussalam, achieved impressive growth rates in 1994, ranging from about 5 per cent in the Philippines to 10 per cent in Singapore. Furthermore, all the countries were able either to maintain or exceed their GDP growth rates achieved in the previous year. The Philippines has made an outstanding turn-round, its economic recovery which started in 1993 sharply accelerating in 1994, with GDP growth more than doubling from 2 per cent in 1993 to about 5 per cent in 1994. The industrial and services sectors were the main contributors to sustained high growth rates in all the countries. Buoyant exports were also responsible for achieving high growth rates. High economic growth has, however, given rise to some inflationary pressures in these countries. Inflation rates were higher in all the countries in 1994 compared with 1993. Viet Nam recorded double digit inflation in 1994, Indonesia and the Philippines were close. The rising inflation rates reflect to some extent the infrastructural constraints being faced by these countries. The large inflow of portfolio investments has also been a contributing factor.

Output growth

Brunei Darussalam's economy is dominated by the oil and gas sector. However, the share of the sector in GDP has been falling over the years because of falling oil prices and the Government's efforts to diversify the economy through the provision of greater resources for other sectors, especially the services sector. The share of industry dominated by hydrocarbons-related activities has also markedly declined since the mid-1980s. Despite the reduction, the weight of oil and gas remains heavy and hence GDP recorded negative growth both in 1992 and 1993 (see table II.9), largely caused by lower oil prices. Oil prices further declined in early 1994 but picked up in the remainder of the year. GDP was expected to register a small but positive growth rate in 1994.

After growing at 7.0 per cent or more during the period 1989-1991, GDP growth in Indonesia has stabilized to a slightly lower rate of around 6.5 per cent since 1992. GDP grew at 6.6 per cent in 1994. The industrial and services sectors were major contributors towards the sustained high growth rate. The agriculture sector suffered some set-backs in 1994. The production of rice was expected to fall. The recent drought and forest fires seriously affected the production of other agriculture products such as rubber and palm oil. More than 5 million hectares of forest, brush and grassland were damaged by fires in Sumatra and Kalimantan during the dry season of 1994. Nevertheless, agricultural output was estimated to have grown by 4.5 per cent.

Malaysia has been recording a consistently high growth of about 8 per cent or more over the last seven years. GDP grew by 8.4 per cent in 1994, practically the same rate as in 1993. The high growth rate in Malaysia has been sustained by the improved performance in manufacturing, construction and services. The manufacturing sector continued to be the dominant source of growth in the economy. The strong expansion came from both the domestic market-oriented industries and export-oriented industries. The construction sector has maintained strong growth, owing to the implementation of several ongoing and new large infrastructure projects, coupled with the continued expansion in the construction of residential, commercial and industrial buildings. The services sector also maintained its performance of about 8 per cent as a result of the continued good performance of finance, insurance, real estate and business services. An increase in tourist arrivals also helped this sector. The agriculture sector growth of 3.9 per cent in 1993 was sustained by strong growth in palm oil and livestock production. In 1994, however, the growth rate of this sector fell to 1.2 per cent.

After virtually stagnating in 1991 and 1992, GDP in the Philippines grew moderately by 2.0 per cent in 1993. The momentum accelerated in 1994 with GDP growing at 4.5 per cent. The industrial sector was the biggest contributor to this turn-round in the economy. The easing of power shortages in the country raised the growth of industry from 1.8

Table II.9. Growth rates, 1991-1994. Selected South-East Asian economies

(Percentage)

		Rates of growth			
		Gross domestic product	*Agriculture*	*Industry*	*Services*
Brunei Darussalam	1991	3.6	4.8	4.9	1.5
	1992	−1.0	6.4	−5.3	6.0
	1993	−4.0	−1.6	−7.4	0.8
Indonesia	1991	6.9	1.6	9.9	6.2
	1992	6.4	6.5	5.4	7.5
	1993	6.5	1.4	6.9	8.3
	1994	6.6	4.5	8.0	6.3
Malaysia	1991	8.7	−0.0	11.2	10.1
	1992	7.8	4.3	8.8	8.2
	1993	8.5	3.9	9.6	8.2
	1994	8.4	1.2	10.9	7.9
Philippines	1991	−0.4	1.4	−3.6	1.5
	1992	0.6	0.4	−0.5	1.7
	1993	2.0	2.0	1.8	2.1
	1994	4.5	2.9	6.0	4.0
Singapore	1991	6.7	−9.4	7.7	6.1
	1992	6.0	1.1	5.4	6.4
	1993	9.9	−2.4	9.3	10.4
	1994	9.8	−2.0	13.3	7.8
Thailand	1991	8.1	5.0	11.9	5.9
	1992	7.6	4.0	9.3	7.2
	1993	8.1	2.4	11.3	6.3
	1994	8.3	2.5	12.1	6.4
Viet Nam	1991	6.0	7.0	9.1	3.2
	1992	8.6	7.2	11.7	6.9
	1993	8.1	3.8	11.0	9.1
	1994	8.8	3.9	14.1	10.1

Sources: See the source notes in table II.2.

Note: Data for 1994 are estimates.

per cent in 1993 to 6 per cent in 1994. Food manufactures, petroleum products and electrical machinery were main contributors to the improvement in manufacturing activities. Growth in electrical machinery benefited from increased domestic and foreign demand for microcircuits, electrical wiring products and electrical appliances. Partly benefiting from the improved performance of the industrial sector, the services sector was estimated to grow by 4 per cent in 1994 as against 2.1 per cent in 1993. As a result of deregulation, stronger growth in transport and communication services was recorded. The finance sector, helped by greater foreign portfolio investment, showed improved performance. The services sector also benefited from an influx of tourists.

Singapore achieved very close to double digit growth rates in the past two years, the highest in South-East Asia. The manufacturing sector which accounts for a little more than one fourth of GDP has been the star performer, growing at 9.8 per cent in 1993 and at 14.5 per cent in 1994. Within the manufacturing sector, the electronic industry has been the main contributor to sustained high growth. The demand for electronic products from the United States and Europe has spearheaded this expansion. The construction sector recorded an improved performance (12.2 per cent) in 1994 compared with 1993 (8.0 per cent) mainly because of public sector investment in housing and transportation. The services sector accounts for about two thirds of GDP and its performance in 1994 compared with the previous year remained weak mainly because of the slow growth of financial and business services. The volatility of these services largely reflects fluctuations in the stock market. The commerce subsector maintained its previous year's performance, while that of the transport and communications subsector improved marginally.

Thailand's economy in 1994 stayed on the fast growth track it has been following since 1987. GDP was estimated to grow by 8.3 per cent in 1994 as against 8.1 per cent in 1993. The strong performance of the industrial sector has been the backbone of the high economic growth of the country. Industry was to grow by 12.1 per cent in 1994 compared with 11.3 per cent in 1993. The persistent high growth of the industrial sector has also been accompanied by a shift away from low value-added manufacturing activities. Thailand is increasingly becoming an important producer and exporter of higher value-added manufactures such as electrical appliances and computer parts. Improved weather conditions in 1994 contributed to a marginal increase in the growth rate of agriculture from 2.4 per cent in 1993 to 2.5 per cent in 1994.

Since 1992, Viet Nam's economy has been growing at over 8 per cent. In 1994, GDP was estimated to expand by 8.8 per cent. Despite unfavourable weather conditions in some parts of the country, the agricultural sector managed to grow at 3.9 per cent, marginally higher than in 1993. The industrial sector performance remained strong at 14.1 per cent. With sustained policy reforms, the private sector has been growing fast in recent years. Public sector enterprises have also been performing better; as a result, their share in total industrial output has remained stable. The services sector was estimated to grow by more than 10 per cent. A noteworthy event in 1994 was the lifting of the American economic embargo. Alhough its immediate impact on the economy in terms of investment from and trade with the United States has not been large, its positive impact is expected to be quite significant in the coming years.

Demand components

In Indonesia, investment activity remained relatively weak in the beginning of 1993 but it started to pick up in the last quarter of the year. The increase in investment was more visible in the private sector, especially in the construction and manufacturing sectors, in line with a marked increase in banking credit to those sectors in 1993/94. The Government took further deregulation measures in 1993 and 1994 aimed at promoting investment. Major changes were introduced in foreign investment legislation. It is expected that these measures will provide a new boost to investment in the coming years. An increase in the confidence of the investors is already reflected by a sharp increase in approvals of both the domestic and foreign investment projects, particularly since the fourth quarter of 1993. Rising disposable income helped improve gross domestic savings from 37.4 per cent in 1992 to 38 per cent of GDP in 1993 (table II.10). This, in turn, reduced the need for foreign savings, as reflected in a lower current account deficit as a percentage of GNP. The narrowing saving-investment gap had a positive impact on efforts to lower interest rates, which were still relatively high in early 1993. Since mid-1993, a less restrictive monetary policy is being pursued by the central bank to keep interest rates at moderate levels.

Table II.10. Summary of macroeconomic indicators, 1990-1993. Selected South-East Asian economies

(Percentage)

		1990	*1991*	*1992*	*1993*
Indonesia	Savings/GDP	36.7	35.8	37.4	38.0
	Investment/GDP	36.1	35.4	35.6	32.6
	Budgetary balance/GDP[a]	1.5	–1.0	–0.4	–2.0
	Money supply growth	15.9	12.1	7.9	28.6
Malaysia	Savings/GDP	33.4	31.1	35.5	38.3
	Investment/GDP	31.4	37.0	33.8	33.5
	Budgetary balance/GDP[a]	–3.0	–2.0	–0.8	0.1
	Money supply growth	15.6	9.9	12.9	15.7
Philippines	Savings/GDP	17.0	18.8	18.4	15.6
	Investment/GDP	24.8	20.6	21.3	24.1
	Budgetary balance/GDP	–3.5	–2.1	–1.2	–1.4
	Money supply growth	14.3	15.9	9.1	22.3
Singapore	Savings/GDP	45.7	47.4	47.7	47.4
	Investment/GDP	39.5	38.0	40.4	43.8
	Budgetary balance/GDP[b]	2.9	5.1	3.6	4.0
	Money supply growth	11.0	7.7	12.7	23.6
Thailand	Savings/GDP	34.9	35.5	35.2	37.1
	Investment/GDP	41.1	42.0	40.1	43.5
	Budgetary balance/GDP	4.5	4.7	2.9	1.6
	Money supply growth	11.8	13.8	12.3	18.6
Viet Nam	Savings/GDP	2.1	10.1	13.8	14.8
	Investment/GDP	11.5	15.0	17.6	20.5
	Budgetary balance/GDP	–2.6	–1.9	–2.4	–4.4
	Money supply growth	44.2	55.6	58.4	31.4

Sources: See the source notes in table II.3.

Note: Money supply refers to M_1.

[a] Excluding grants and net lending. [b] Excluding grants.

Public investment in Malaysia remained strong during 1993 as a result of development expenditure by public enterprises in gas, energy, communications and transportation. So did private investment, reflecting the coming on stream of the large pool of investment projects approved by the Malaysian Industrial Development Authority in 1990-1991. A significant increase in public investment outlay was expected in 1994 to provide for the implementation of additional infrastructure and human resources and social development projects to address the prevailing constraints. Private investment activity is also expected to remain strong, in line with the improved investment climate, particularly following the recent reduction in corporate tax rates and the introduction of other incentives. Gross domestic savings as a percentage of GDP increased during 1993, reflecting the continued strong performance of the economy as well as the increase in forced savings through the Employee Provident Fund (EPF). The rate of contribution to the EPF was raised by 1 per cent in 1993 to the present rate of 12 per cent for employers and 10 per cent for employees.

Private consumption in the Philippines was estimated to grow by 4.2 per cent in 1994 as against 3.0 per cent in 1993. Higher growth in 1994 can largely be attributed to the economic recovery which raised household income and bolstered consumer confidence. Government consumption, however, increased only marginally reflecting the Government's effort to contain the budget deficit. Overall there was a reduction in savings as a proportion of GDP. Gross domestic investment marked a notable increase. Infrastructural development projects including the expansion of the light railway transit system and other major road and power generation projects provided an impetus to higher investment in 1994.

Domestic demand in Singapore slowed down in 1994 primarily because of the introduction of the goods and services tax at 3 per cent in April 1994. However, this slow growth has been compensated by a robust growth in external demand. Savings has continued to rise in the country since 1986. Gross domestic savings as a ratio to GDP reached 47.4 per cent in 1993 and a further increase to 48.8 per cent was expected in 1994. The main form in which household savings are kept is the Central Provident Fund (CPF). The compulsory CPF rate currently stands at 40 per cent. However, the high savings rate observed now has a considerable discretionary component as well since there has been a progressive liberalization in the use of CPF savings for pre-retirement age. Some funds can be withdrawn for home purchases and for investment in the stock market. On the investment side, gross fixed capital formation was expected to grow by 11.4 per cent in 1994, taking gross domestic investment as a proportion of GDP to 48.8 per cent.

Private and public consumption expenditure in Thailand were expected to grow at 7.9 and 7.5 per cent respectively in 1994, marginally higher than those of the previous year. Investment was expected to continue its high growth. Private sector investment which accounts for more than two thirds of total investment was to grow by 8 per cent. Public investment has been growing at much faster rates in recent years and has been directed mainly at infrastructure and technological and human resources development. The rate of growth of public investment at 22 per cent in 1994 was about the same as in the previous year.

Domestic savings in Viet Nam has increased sharply during the recent years. As a proportion of GDP it increased from only 2.1 per cent in 1990 to 14.8 per cent in 1993 and was estimated to grow further to 16.6 per cent in 1994. Similarly, the investment to GDP ratio increased from about 11.5 per cent in 1990 to over 20 per cent in 1993. The estimated figure for 1994 was 24 per cent. Viet Nam has been attracting large foreign direct investment in recent years. From January 1988 to May 1993, some 696 foreign direct investment licences were issued, with a total subscribed value of $6.2 billion. The growth of foreign direct investment has been even faster since May 1993. For example, the registered capital of licensed projects was approximately $2 billion in the first six months of 1994.

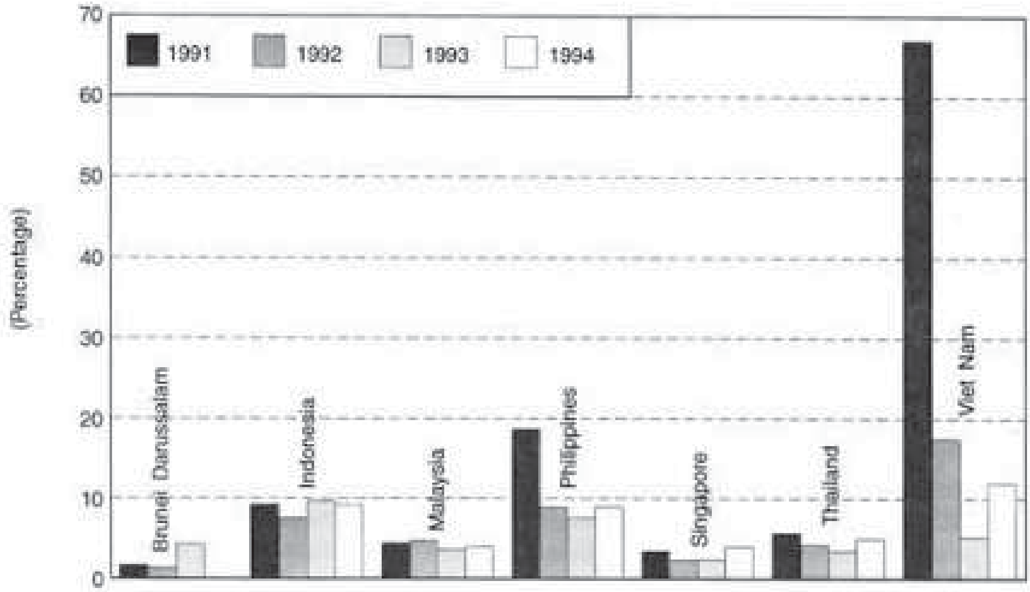
Inflation

As a country heavily dependent on imports, the inflation rate in Brunei Darussalam is largely determined by inflation in the source countries and changes in the exchange rate. The inflation rate remained less than 2 per cent in 1991 and 1992 but rose to over 4 per cent in 1993 (figure II.5). The increase was attributed mainly to rising prices of non-food items.

Inflation in Indonesia accelerated through 1993 to reach 9.2 per cent in 1994 as against 7.5 per cent in 1992. The increase in prices largely came from an upward adjustment in administered prices including energy prices, which in turn, caused a cost-push in non-administered prices. Unfavourable weather conditions boosted food prices. Cement prices have risen sharply since June 1994. Salaries of government officials were raised effective January 1994. The minimum wages of workers in the private sector were also revised upward. A less restrictive monetary policy has been another contributory factor to inflation.

Malaysia has had a stable price level with an inflation rate of less than 5 per cent during recent years. The low inflation rate in Malaysia can be attributed to the Government's basic commitment to macroeconomic stability. A tight monetary policy, supplemented by fiscal restraints, has been pursued to mop up excess liquidity. The country's usually low budgetary deficit was converted to a small surplus in 1993. A balanced budget was expected for 1994. Some administrative measures were also introduced to control inflation. Those included compulsory price tagging on all retail items and more frequent and stricter price checks to ensure that the benefits of the abolition or reduction of imports duties on more than 1,100 items in the 1993 and 1994 budgets were passed on to consumers. Inflation was expected to remain around 4 per cent in 1994. The country is facing an ever rising labour shortage which exerts pressure on wages and prices. In the short run, the problem can be tackled by easing restrictions on the entry of foreign workers. But over the longer term, the problem can be solved only by increasing productivity. Moreover,

Figure II.5. Inflation rates,[a] 1991-1994. Selected South-East Asian economies



Sources: See the source notes in table II.2.

[a] Refer to changes in consumer price index.

it will be necessary to encourage more women and early retirees to join the work force.

Inflation in the Philippines which reached nearly 20 per cent in 1991 dropped to 7.6 per cent in 1993, but edged up to 9.0 per cent in 1994. With the sustained appreciation of the peso during 1994, the explanation of higher inflation has to be found primarily in domestic factors. Two major typhoons contributed to the increase in food prices. The main factor behind accelerating prices was monetary growth. In 1993, total domestic liquidity grew by 13.9 per cent, while it went up by 22.9 per cent for the first six months of 1994. Growth in monetary aggregates can be attributed significantly to an increase in net foreign assets, largely resulting from an inflow of foreign investment, particularly portfolio investment. On the fiscal side, huge debt-service commitments have reduced the Government's degree of freedom with respect to meeting development and other needs of the country. Nevertheless, the Government has been able to contain the budget deficit to low levels compared with many other developing countries. With improved tax administration and better control on expenditure, the budget deficit was expected to come down further in 1994 from 1.4 per cent of GDP in 1993.

The rate of inflation in Singapore, traditionally low, rose to 4 per cent in 1994 as against 2.4 per cent in 1993. With the unemployment rate around 2.5 per cent, the labour market continues to remain tight. However, the main impetus to higher inflation came from the introduction of goods and services tax. The inflation rate could be higher but for appreciation of the domestic currency which kept imported inflation in check. Also, growth in money supply (M_1) was expected to be contained to 18.6 per cent in 1994, lower than the 23.6 per cent observed in 1993. The Monetary Authority of Singapore has traditionally relied on the management of the exchange rate rather than domestic monetary instruments to control inflation since it has little control on monetary variables as a small and open economy. More than 70 per cent of Singapore's domestic prices are determined by external factors and there are no restrictions on the inflow and outflow of capital. Prudent fiscal policy and balance-of-payments surplus have kept the Singapore currency strong, and hence domestic inflation is low.

In Thailand inflationary pressure which showed a declining trend since 1991 has re-emerged in 1994. The inflation rate was expected around 5 per cent in 1994 as against 3.5 per cent in 1993. Price increases of farm products were more pronounced. A number of factors have contributed to this recent surge in inflation. The shortage of skilled workers in some industries is becoming a serious problem. Money supply (M_1) grew at a higher rate in 1994 than in 1993. Salaries of government employees were raised in 1994. The Government has been maintaining a surplus in the budget in recent years, but the surplus seems to be declining.

After slowing down dramatically in recent years, inflation in Viet Nam again picked up in 1994. From 67 per cent in 1991, it declined to 17.5 per cent in 1992 and further to 5.2 per cent in 1993. Inflation was estimated to reach a rate of 12 per cent in 1994. Most of the increase was contributed by rising food prices, which in turn, raised non-food prices also. Prices of services also went up significantly. The Government took certain measures to control inflation but they apparently had a limited effect. Imports of certain scarce commodities such as building materials, sugar and fertilizer were increased. Certain measures were introduced to encourage the use of the national currency in the country to increase control over the money supply and reduce transactions in United States dollars. However, the money supply grew at a slightly higher rate in 1994 than in 1993. On the fiscal side, revenue grew at a greater speed than expenditure, thereby reducing the budget deficit as a proportion of GDP in 1994 compared with 1993.

Policy responses

Malaysia, Singapore and Thailand have a surplus government budget. In the case of Malaysia, a small surplus was recorded in 1993, the first one in many years. Some new tax measures were introduced in 1993, which included a one percentage point reduction in the corporate income tax rate to 34 per cent, abolition of the 2 per cent development tax for both individuals and companies and across-the-board reductions of 1-2 per cent in the marginal income tax rates for individuals and co-operatives.

In Singapore, a number of fiscal policy changes were introduced in 1994. As stated earlier, goods and services tax was implemented in April 1994. The rate at 3 per cent will be kept constant for the first five years. There are exemptions for certain financial services and for the sale and lease of residential land and buildings. Zero rating is applied to the export of goods and specific international services. The Government lowered the corporate tax by 3 per cent (from 30 to 27 per cent) and the top income tax rate also by 3 per cent (from 33 to 30 per cent). The main purpose of these tax cuts was to enhance Singapore's competitiveness and to provide more incentives to work and save. The net impact of these tax measures was expected to add to a government budget surplus in 1994.

Among the major policy changes by the Government in Indonesia in June 1994 were lowered tariff rates for 739 import items, reduced tariff surcharges for 121 commodities and the removal of 27 items from the list previously subject to prior approval. The Government of Indonesia unveiled a deregulation package on 2 June 1994. It allows foreign investment in nine major sectors previously closed to foreign investors. Those included seaports; the generation, transmission and distribution of commercially used electricity; telecommunications; shipping; civil aviation; drinking water supply; railways; nuclear power generation; and the mass media. The negative list for foreign investors in the process was reduced to 34 sectors, dealing mainly with domestic distribution and retailing and sectors reserved for small-scale firms. The deregulation package allows 95 per cent of equity owned by foreigners in joint ventures. Restrictions on the minimum level of initial foreign investment have been removed.

In Thailand, the central bank raised the bank rate, and the refinancing rate on the finance companies' promissory notes in September 1994 in light of the potential impact of the underlying monetary conditions on inflation. With rather low mean years of schooling of workers, a major policy priority in Thailand is to improve the quality of human resources. The budget for 1994 provided a number of fiscal incentives for private sector investment in education.

The Vietnamese Government introduced some new measures to strengthen the role of market forces in the economy. In July 1993, the National Assembly of Viet Nam approved a new land law, under which annual crop farmers were given 20-year renewable tenure rights to their land, to a maximum of three hectares. The new law allows citizens to transfer, exchange, lease and inherit rights to use farmland. They can also use land as collateral for obtaining loans. The new law provides security of tenure and freedom of land use by households.

The use of foreign currencies in business settlements is quite widespread in Viet Nam. Therefore, the Government implemented certain measures in October 1994 to encourage the use of the national currency to gain better control over the money supply and reduce the use of the United States currency in the economy. Foreign currency receipts resulting from export, import, services and all other foreign currency incomes obtained within the country must be deposited in banks allowed to handle foreign currency business in Viet Nam. The organizations are allowed to retain a part of the foreign currency deposited in their accounts for their business activities. Shops and enterprises providing services for payment in foreign currencies within the country must change to settlement in the national currency, except for those servicing foreign passengers at airports and seaports.

East Asia

Over the past decade, China, Hong Kong and Republic of Korea have maintained a fast pace of economic growth. The remarkable performance of these economies can be attributed to high rates of investment, technological upgradation, enhanced productivity and flexible economic policies to promote active participation in the international division of labour. The average growth of these economies was estimated to be 9.8 per cent in 1994 compared with 9.7 per cent in 1993, despite a major upsurge in the growth performance of the Republic of Korea. The explanation lies in reduced growth in China, estimated to be 11.8 per cent in 1994 compared with 13.4 per cent in 1993. In recent years, China has emerged as an important locomotive for growth in its neighbouring countries through closer trade and investment linkages.

The other two developing members of ESCAP from East Asia are the Democratic People's Republic of Korea and Mongolia. Development issues faced by these two countries are qualitatively different from those faced by other economies of East Asia. As a disadvantaged economy in transition Mongolia continues its economic reforms aimed at a restrained money supply, reduced inflation, steady exchange rate and an increase in foreign reserves. In the Democratic People's Republic of Korea, reform measures are yet to become as comprehensive.

Output growth

After two successive years of over 13 per cent growth, the rate of growth in China decelerated to an estimated 11.8 per cent in 1994 (table II.11), partly owing to policy measures to contain inflationary pressure. Since China started economic reform and open-door policies at the end of the 1970s, its output has increased by an average annual growth rate of 9 per cent. The current indications are that a similar rate will be sustained through the remaining years of this century. An important element in growth strategy in China has been the pursuit of efforts to diffuse improved technologies beyond major urban centres (see box II.3).

During 1994 China suffered heavily from natural disasters of one form or another. The heavy floods in south China and severe drought in the north badly hit the country's agriculture and infrastructure. After a record grain crop in 1993, agricultural production was expected to increase by 3 per cent in 1994 compared with 4 per cent in 1993. Industrial production was expected to grow by about 16 per cent, considerably lower than 23.6 per cent recorded in 1993. The growth of this sector was led by private investors, both domestic and foreign.

The link between the economies of China and Hong Kong has become closer over the years. Hong Kong has thus benefited from the continuing rapid growth in China. As a highly export-oriented economy, it also benefited from the recovery of the industrialized countries. GDP grew by 5.6 per cent in 1993. The estimate for 1994 indicated a slightly lower rate at 5.4 per cent mainly because of a slow-down in domestic demand, following strong growth in private consumption in 1993.

After averaging a strong economic growth of about 12 per cent during the period 1986-1988, the economy of the Republic of Korea witnessed a downturn in 1989 when the rate of growth dropped to one half of the preceding three-year average. The downslide was reversed by massive housing investment projects which boosted the growth rate to over 9 per cent in 1990 and 1991. With the completion of those construction projects in 1991, the economy again slipped back to a growth rate of just over 5 per cent in 1992 and 1993. A new phase of strong expansion appeared to have emerged in 1994 with the economy growing at an estimated 8.6 per cent. The expansion was fostered by a large increase in industrial exports and significant expansion in investment and to a lesser degree, in private consumption.

Tightening fiscal and monetary policies to arrest inflation and liberalizing prices along with the adoption of a floating exchange rate were the top priorities of the Mongolian Government in 1993. The progressive decline in inflation since 1993 and

Table II.11. Growth rates, 1991-1994. Selected East Asian economies

(Percentage)

		Rates of growth			
		Gross domestic product	Agriculture	Industry	Services
China	1991	8.2	3.0	12.9	5.8
	1992	13.0	3.7	20.8	9.2
	1993	13.4	4.0	23.6	10.0
	1994	11.8	3.0	16.0	10.2
Hong Kong	1991	4.1	..	..	..
	1992	5.3	..	..	..
	1993	5.6	..	..	..
	1994	5.4	..	..	..
Mongolia	1991	-9.9	-5.1	-13.2	-11.6
	1992	-7.6	-3.9	-13.1	-12.0
	1993	-1.3	-7.0	-5.5	2.7
	1994	2.5	..	..	..
Republic of Korea	1991	9.1	0.4	9.2	10.6
	1992	5.1	6.0	3.5	6.3
	1993	5.5	-2.4	4.5	6.8
	1994	8.6	..	..	..

Sources: See the source notes in table II.2.

Note: Data for 1994 are estimates.

relative stability of the national currency, the tugrik, suggest that the country has achieved a degree of success in its objectives. While GDP is still far below the level of the end of the 1980s, it is significant that the rate of decline has consistently fallen since 1991. GDP declined by 9.9 per cent in 1991, 7.6 per cent in 1992, and only 1.3 per cent in 1993. The current estimates were that GDP grew by 2.5 per cent in 1994, the first year of positive growth in the last five years. The grain harvest was estimated to be 450,000-500,000 tons in 1994, which would make the country self-sufficient in flour.

Demand components

Fast growth in China was largely underpinned by investment. As a proportion of GDP, investment grew to 42.8 per cent in 1993, compared with 36.5 per cent in the previous year (table II.12). The Government intended to limit the increase in investment in fixed assets to 10 per cent in its 1994 budget as a means of containing inflation. Available data suggest that this target could not be met, although the rate of growth of investment in 1994 was considerably lower than in 1993. The country also succeeded in reducing the growth of money supply which declined from 30.3 per cent in 1992 to 21.6 per cent in 1993. The rate most likely came down further in 1994.

Improvement in tax collection and decline in the subsidies paid to loss-making state enterprises resulted in a reduction of the budget deficit as a proportion of GDP in China in 1993. The budget for 1994 stipulates that treasury bonds would be the sole means of financing budget deficits, unlike the previous years when the deficit was financed by borrowing from the central bank causing an aggravation of inflationary pressure in the economy.

With a conservative fiscal policy stance, Hong Kong has often maintained a surplus in its budget. However, the surplus as a proportion of GDP dropped markedly in 1993, partly because of expenditures on infrastructure projects. However, public spending in Hong Kong came down from 18.7 per cent of GDP in 1993 to 18.1 per cent of GDP in the beginning of 1994. Government consumption

Box II.3. Upgrading rural industrial technology: the experience of China and India

Accelerated and sustained economic growth, and the equitable distribution of its benefits require an accelerated growth of the still large rural economies of many countries in the region. That, in turn, requires an upgrading of the technical base of rural production, substantial proportions of which are accounted for by rural industrial units. These industries, however, most often operate with crude and outdated technologies which limit their production potential and contribution to the national economy. The adoption of more advanced technology in these production units, which have strong linkages with agriculture, can greatly enhance output and employment opportunity in the rural areas. The experience of China and India, the two largest developing countries of the region, are instructive in this regard.

China adopted the SPARK programme in 1985 as an experiment, followed by its regular implementation from 1986, for the introduction of better production techniques in its rural economy. More than five million rural technical and managerial personnel have been trained as a core force and "tinder" to propagate the "SPARK technologies". More than 100 kinds of technical equipment for rural use have been developed and introduced. This has accelerated the technical transformation of village and township enterprises. The implementation of the SPARK programme has enhanced the scientific and technical consciousness in rural areas and provided opportunities for further innovation.

The impressive development in China's rural areas nationwide is well documented. Between 1978 and 1992, the number of township and village enterprises increased from 1.5 million to 20.8 million and the total labour force employed in these enterprises rose from 28.3 million to 105.8 million. The gross output value increased from 49.3 billion to 1,797.5 billion yuan renminbi during this period. Of the total number of township and village enterprises, 38 per cent were industrial enterprises which accounted for 60 per cent of the employment and 75.9 per cent of output of the township and village enterprises.[a]

The introduction and utilization of better technologies was promoted through a supportive science and technology (S and T) policy and institutional environment. Cooperative relationships among rural and urban industries, among township and village enterprises, and between them and foreign companies have been well established through organizational and policy support from government levels. The national policy and institutional environment included:

(a) The high commitment of the Government towards S and T based rural development, reflected in the setting up of local S and T commissions and the provision of significant budgetary resources for specific S and T programmes, such as the SPARK and TORCH[b] programmes of the State Science and Technology Commission;

(b) Decentralization of financial and decision-making authority to provincial and local governments to enable them to improve the physical and social infrastructure in rural areas and attract foreign direct investment;

(c) The establishment of S and T institutions at the provincial and local levels to facilitate the transfer, development, adaptation, adoption and diffusion of technology for rural industries;

(d) Public financial support for in-house research and development (R and D) and joint R and D among rural industries, and increased provision of bank loans for financing technology acquisition and upgrading.

Technology linkages among urban, foreign and rural industries, took the following forms:

(a) Exchange of technology information among related parts and component producers;

(b) Provision of technical advice, know-how and training by large urban industries in connection with ancillary supplier and buyer relationships;

(c) Provision of technical advice in connection with foreign direct investment and joint venture arrangements.

In India, the rural industries have proved to be an important instrument for alleviating poverty, generating productive employment and minimizing income disparities. Agro-based industries are the most important industrial activities of the rural economy.

A vast network of S and T and support service institutions has been set up in the country in order to assist the village and small-scale industries. Education, training and research, and assistance in marketing and procurement of finance, raw materials and other inputs are among a wide variety of services provided to these industries through this support service network. To promote ancillary relationships and technology linkages among large and small industries in urban and rural areas, the Government has recently allowed

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[a] State Statistical Bureau of the People's Republic of China, *China Statistical Yearbook 1993* (Beijing, China Statistical Information and Consultancy Service Centre, 1993).

[b] The Torch programme is aimed at developing and adopting high-technology in firms.

(Continued overleaf)

(Continued from preceding page)

equity participation by large firms in small enterprises and has established subcontracting exchanges for registering and providing information to large enterprises on the capacity of small enterprises to produce components and intermediates.

Many of India's rural industries still face a variety of problems ranging from weak management capabilities and technical skills, outdated technology, and non-availability of raw materials. Nevertheless, there are promising developments towards the technological advancement of rural areas based on increased access to credit, subsidies and incentives. The improvement of infrastructural facilities and the implementation of Integrated Rural Development Programme (IRDP) have facilitated the process further. All these have resulted in a significant shift in the occupational pattern from the agricultural to the secondary and tertiary sectors and an average 45 per cent increase in rural family income in the post IRDP-period. The IRDP programmes included the provision of technology inputs to rural industries through the network of technology extension, demonstration and training centres, and the involvement of a large number of voluntary agencies in government activities concerning the creation of awareness, human resources development, dissemination of information, skill upgradation and the transfer of technology.

Current efforts of the National Science and Technology Entrepreneurship Development Board (NSTEDB) include the establishment of entrepreneurship development cells and S and T entrepreneurs parks in and around academic and research institutions. Some of these projects have contributed to rural industrialization. In 1992, the NSTEDB started a pilot scheme on Mass Employment Generation through Science and Technology (MEGSAT) which has already led to encouraging results. During a period of three years, about 20,000 new jobs have been created, about 75 per cent of which were created in rural areas with a significant representation of women. Other departments and institutions have started science park establishments, such as the Bio-tech Industries Consortium, and the Electronics Hardware and Software Technology Parks.

growth was expected to remain at about 5 per cent in 1994/95. The largest component in domestic demand, private consumption expenditure, was expected to grow at about 9 per cent in 1994. Real gross domestic fixed capital formation rose by 7 per cent in the first quarter of 1994 and 9 per cent in the second. Overall expenditure on building and construction rose by 15 per cent in the second quarter of 1994, up from 7 per cent in the previous quarter.

Table II.12. Summary of macroeconomic indicators, 1990-1993. Selected East Asian economies

(Percentage)

		1990	*1991*	*1992*	*1993*
China	Savings/GDP	40.2	38.1	37.9	37.8
	Investment/GDP	34.8	35.1	36.5	42.8
	Budgetary balance/GDP[a]	–0.8	–1.0	–1.0	–0.7
	Money supply growth	20.1	28.2	30.3	21.6
Hong Kong	Savings/GDP	33.3	31.2	31.1	31.2
	Investment/GDP	28.4	28.2	29.1	27.5
	Budgetary balance/GDP[b]	0.7	3.5	2.9	1.8
	Money supply growth	13.3	19.5	21.1	20.6
Mongolia	Savings/GDP	2.5	3.5	3.0	..
	Investment/GDP	32.3	21.3	12.4	..
	Budgetary balance/GDP[a]	–13.5	–9.7	–12.0	–15.6
	Money supply growth	35.5	54.0	4.5	134.3
Republic of Korea	Savings/GDP	36.2	36.4	35.2	35.1
	Investment/GDP	36.9	38.9	36.6	34.3
	Budgetary balance/GDP[a]	–0.7	–1.6	–0.8	–0.2
	Money supply growth	11.0	36.8	13.0	18.1

Sources: See the source notes in table II.3.

Note: Money supply refers to M_1.

[a] Excluding grants. [b] Excluding grants and net lending.

Despite the importance of exports in the economy of the Republic of Korea, domestic demand remains a major element in the country's growth performance. Final consumption expenditure in 1994 rose by an estimated 7 per cent, at a rate lower than the rate of growth of GDP. As government consumption increased by only 4.6 per cent reflecting successful efforts to reduce current outlays, the increase in aggregate consumption was mainly the result of greater household expenditure.

Fixed investment as a proportion of GDP was estimated to have increased slightly in 1994 over the 34.3 per cent recorded in 1993. Investment in equipment enjoyed strong growth with a rate of 18.8 per cent. However, construction investment recorded much lower growth despite an upsurge in the last quarter as the Government took up construction of various infrastructure projects.

Greater local demand for foreign goods and services in the Republic of Korea, coupled with liberalization policies, has been the driving force of the recent rise in foreign direct investment into the country. After suffering steady declines since the late 1980s, inward foreign investment climbed by 17 per cent in 1993, including a 52 per cent growth in services and 92 per cent in wholesale and retail trade. Between 1991 and 1993, the share of services in foreign investment rose from 23.4 to 49.5 per cent. The total amount of foreign direct investment in the Republic of Korea was $5.5 billion during the period 1988-1992. Outward foreign investment also increased considerably from $116 million in 1985 to $1.3 billion in 1993, 50 per cent of which went to Asian countries.

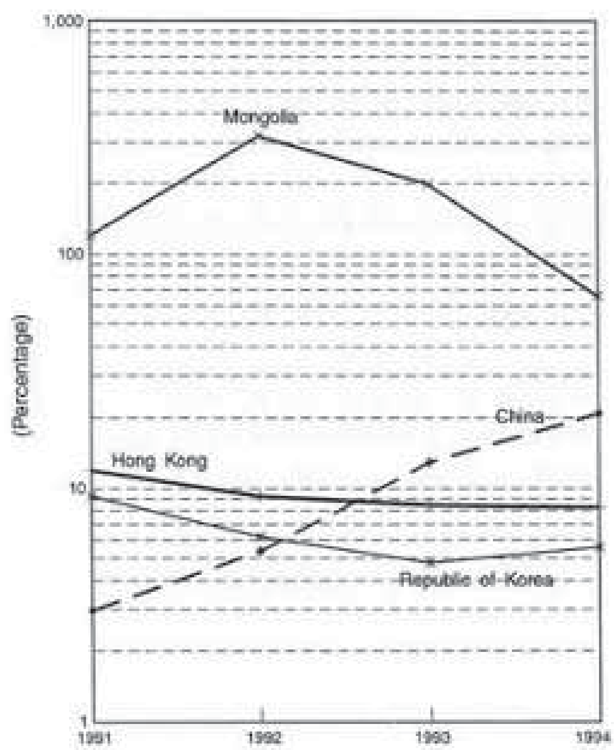
According to the 1994 state budget of Mongolia, total budget revenues in 1994 were projected at 82.1 billion tugriks and expenditures at 94.8 billion tugriks which means that the budget deficit would amount to 12.7 billion tugriks. Budget revenue and expenditure increased by 26 and 30 per cent respectively in 1994 in comparison with the state budget of 1993. The absolute magnitude of the budget deficit would thus widen despite efforts to contain it through a number of measures to increase revenue as well as to reduce expenditure. The Government has adopted a policy of meeting budgetary deficit through external assistance and the sale of domestic bonds rather than borrowing from the central bank.

Inflation

Controlling inflation became a significant concern for East Asian economies in 1994. Inflation in China was estimated to be above 20 per cent in that year (figure II.6). Among the explanatory factors were the persistent investment boom despite government efforts to contain it, the liberalization of prices, exchange rate reforms and an increase in foodgrain prices resulting from a decline in summer grain output. It is expected that inflation will be reduced to below 15 per cent in 1995.

The inflation in Hong Kong was estimated at 8.3 per cent in 1994, slightly lower than the rate of 8.5 per cent in 1993. Lower import prices of food, a stable labour market and rather modest increases in rents helped stabilize the inflation rate in Hong Kong.

Figure II.6. Inflation rates,[a] 1991-1994. Selected East Asian economies



Sources: See the source notes in table II.2.

Note: Scale on the vertical axis is in logarithm.

[a] Refer to changes in consumer price index.

Consumer prices at the end of 1994 in the Republic of Korea were 5.6 per cent higher than in the previous year. This was mainly attributable to several rounds of price increases in agricultural products, particularly fruits and vegetables. Public service charges such as taxi, bus and railway fares and school tuition fees also registered substantial increases. There were some concerns that rising wages and demand pressures in the wake of the economic boom might lead to severe inflationary pressure. However, by the year-end there was only a mild increase which did not pose a threat to the stability of the economy.

The economic reform efforts of Mongolia continued with vigour and the success of stabilization measures was reflected in a marked fall in inflation to 200 per cent in 1993 from over 300 per cent in 1992. This was accomplished through a combination of monetary and fiscal policy measures. The interest rate on credit granted to commercial banks was raised several times in 1993, as was the obligatory reserves required to be maintained by commercial banks with the central bank. The tight monetary policy was supplemented by fiscal actions which included careful monitoring and reduced expenditure on subsidies, wages, health care and education. A substantial fall in inflation was expected in 1994.

Policy responses

Over the past two years China has implemented extensive reforms encompassing price determination, ownership of state enterprises, fiscal and financial systems and external trade. Prices of grain and edible oil have been deregulated. Price controls on a number of energy and material inputs have been removed. By the end of 1993 the Government's direct control over prices extended to only 5 per cent of total value of retail sales. Reforms with regard to the ownership of state-owned enterprises now permit large stakes in those enterprises to be sold to domestic or foreign private enterprises. In addition, efforts were made to reduce the state enterprise losses. The banking system has been revamped, the specialized banks have been freed from the obligation to subsidize loss-making enterprises. The two-tier exchange rate system has been replaced by a unified regime and trading companies have been freed from the obligation to turn over all foreign currency to the Government.

Since 1993, the Government of Hong Kong has adopted a new fiscal stance geared to increased public expenditure on education, housing, health, pensions and family welfare. In addition to substantial welfare expenditure, the Government was also committed to increasing infrastructure investment. The share of the public sector in overall building and construction expenditure is expected to exceed 50 per cent in 1994 from 44 per cent in 1993. Increased demand for services, including infrastructure, was an important part of the process of adjustment to higher income levels in Hong Kong.

Recent economic reforms in the Republic of Korea have focused on enhancing the country's international competitiveness. A number of deregulation and liberalization measures have been instituted with that end in view. As a part of the phased liberalization of financial markets, interest rates on loans financed by the Government and the central bank, in addition to rates on all deposits, except demand deposits, have been deregulated since early January 1994. Interest rates for loans from non-bank institutions such as insurance funds, credit unions and mutual funds were also liberalized. The average tariff rate was to be reduced to about 8 per cent by 1994. The Government has implemented plans to streamline procedures for foreign investors. Those included a reduction in the required ratio of retained earnings and permission for foreign firms to buy land for non-speculative purposes.

Major economic and structural reform measures of the Mongolian Government aimed at improving macroeconomic management including stabilization of the exchange rate, reduction of the budgetary deficit and a curb on inflationary pressure. In addition to fiscal and monetary policy measures referred to earlier, from July 1993, the Mongolian currency has been made convertible on the domestic market. Measures have been taken to increase foreign exchange reserves at the disposal of the Government through the purchase of a certain portion of export proceeds earned by economic entities. General export licensing was abolished. The import tariff has been reduced to 15 per cent and the tariff system has been converted to the harmonized system consistent with international practice.

The Government of the Democratic People's Republic of Korea announced a new economic policy package stressing agriculture, light industry and foreign trade as top priorities. New laws on banking have been enacted. The leasing of land to foreigners has been permitted in order to promote foreign direct investment.

Developed economies

In contrast to the developing countries, the developed countries (Australia, Japan and New Zealand) of the ESCAP region, in recent times, have faced recessionary conditions reflecting cyclical fluctuations typical of other developed countries of Europe and North America. While the economies of Australia and New Zealand were already out of the recessionary phase and performed well in 1994, the recovery of Japan has only just started.

Much of the growth in the three developed countries in 1994 has been contributed by manufacturing industries and construction. The latter, especially house building, was found to be particularly responsive in Japan to the anti-recessionary fiscal and monetary incentives offered by the Government and provided a major growth impulse for the country.

In 1994, control of inflation at extremely low levels remained the main preoccupation of the monetary authorities. Fiscal policies, except for Japan, have been tight and depended more on expenditure control than on higher tax rates to improve the budget balance.

Output growth

In Australia, the process of economic recovery which began in 1992 gained further momentum. In 1994, the growth rate of GDP has been estimated at 4.7 per cent compared with 3.5 per cent in 1993 (table II.13).

Table II.13. Major macroeconomic indicators, 1990-1994. Developed countries in the ESCAP region

(Percentage)

	1990	*1991*	*1992*	*1993*	*1994*[a]
Australia					
GDP growth	1.3	-1.3	2.5	3.5	4.7
Inflation	7.3	3.2	1.0	1.8	2.0
Consumption/GDP	75.4	78.7	81.1	81.9	82.4
Investment/GDP	21.1	18.6	17.2	18.1	18.2
Budget balance/GDP	0.5	-2.8	-3.9	-3.7	-4.0
Short-term interest rates	14.4	10.1	6.5	5.2	5.7
Japan					
GDP growth	4.8	4.1	1.3	0.0	1.3
Inflation	3.1	3.3	1.7	1.2	0.8
Consumption/GDP	66.5	65.8	66.4	67.3	68.5
Investment/GDP	32.2	31.7	30.8	30.2	29.3
Budget balance/GDP	2.9	3.0	1.8	-0.2	-2.7
Short-term interest rates	7.7	7.2	4.3	2.9	2.2
New Zealand					
GDP growth	-0.1	-2.1	-0.2	4.1	3.8
Inflation	6.1	2.6	1.1	1.4	1.5
Consumption/GDP	72.4	74.5	75.6	74.3	73.3
Investment/GDP	20.2	19.8	18.4	19.4	20.0
Budget balance/GDP	4.0	1.9	-2.2	0.1	1.0
Short-term interest rates	13.9	10.0	6.7	6.3	6.7

Sources: United Nations, *Project LINK World Outlook*, various issues; International Monetary Fund, *International Financial Statistics*, vol. XLVII, No. 12 (December 1994) and *World Economic Outlook, October 1994*; The World Bank, *World Tables 1994* (Baltimore, The Johns Hopkins University Press, April 1994); Organisation for Economic Co-operation and Development, *OECD Economic Outlook*, No. 56 (December 1994); The Economist Intelligence Unit, *Country Report: Australia*, 3rd and 4th quarters 1994 and *Country Report: New Zealand*, 3rd and 4th quarters 1994; and national sources.

[a] Estimate.

The improved performance of the economy in 1994 has been mainly the result of buoyancy in the manufacturing industry. From January to June 1994, the production of the manufacturing industry increased by 9.4 per cent over the corresponding period of 1993. Transport equipment recorded the largest increase in the manufacturing group reflecting the resurgence of motor vehicle sales.

Construction of residential houses also substantially increased in 1994. However, compared with 1993, growth has been less. The value of new building projects approved during January to September 1994 increased by 12 per cent over the same period of the previous year.

There are indications that the Japanese economy is now firmly rooted in the process of recovery from the recession which started from the middle of 1991. In 1994, the growth rate of GDP has been estimated at 1.3 per cent compared with no growth in 1993.

The improved performance of the Japanese economy in 1994, to a large extent, has been caused by an increase in construction, especially that of residential housing, which quickly responded to the incentives provided by the Government for boosting the economy.

Industrial production recorded an increase of 1.5 per cent (over the previous quarter) in the first quarter of 1994 and continued upward at a similar pace in the second quarter of 1994. This is accounted for, in part, by the increased production of transport equipment, including automobiles. The industrial recovery process was further confirmed in July and August 1994 when inventories decreased consecutively for two months signalling that inventory adjustments may have been over and production was accelerating.

The economy of New Zealand has been performing well since 1993 after a prolonged recession in the period 1989 to 1992, during which GDP contracted continuously. In 1994, growth of GDP was expected to be 3.8 per cent compared with 4.1 per cent in 1993.

Much of the growth in 1994 was likely to be contributed by manufacturing industries which have been responding positively to the liberalization efforts of the Government. Manufacturing output grew by 4.8 per cent in the second quarter over the same quarter in 1993. Big increases were recorded in output of fabricated metal products, primary food processing and basic metal industries. These industries were expected to continue to show a strong performance in rest of the year.

Activities in the construction sector also picked up during the course of 1994. The value of construction permits issued in the first three quarters increased by around 18 per cent over the same period in 1993 showing the strong performance of this sector. Most of the activities were in the area of residential construction.

Demand components

Private consumption in Australia in 1994 has been strong and was expected to increase by 4.6 per cent in real terms compared with 2.4 per cent in the previous year. On account of the improved economic performance, both employment and wage rates have increased which provided a fillip to private consumption.

During 1994, real spending on dwelling rose by 9.6 per cent. Business spending on equipment was on the rise. Investment spending by the private sector on first hand equipment increased by 13.4 per cent in nominal terms in the second quarter of 1994 over spending recorded in the same quarter in 1993. This sharp increase indicated that the long awaited boom in business investment was underway. Private sector investment in equipment was expected to show even stronger performance in the rest of the year. In 1994, real private investment was estimated to increase steeply by 12 per cent compared with 3 per cent in 1992.

In Australia, the federal budget deficit to GDP ratio in the year 1994 has been estimated at 4 per cent compared with 3.7 per cent in 1993. The major portion of the government outlay has been concentrated in the social areas: social security and welfare, health and education. There has been a continuous demand to increase these welfare expenditures. However, to fulfill the Government's medium-term target of bringing the budget deficit down to 1 per cent of GDP by 1997 the Government has already initiated tight control of expenditure in these areas rather than instituting additional measures to increase tax rates.

In Japan in 1994 private consumption demand gradually responded to the income tax cut of $60 billion effected by the Government and the prevailing low domestic prices. From the middle of 1994, private consumption expenditures started to increase. Sales figures in department stores increased by 4.6 per cent in the month of July 1994 compared with the same period in 1993. The number of newly registered passenger cars in August 1994 increased by 12 per cent over the number observed in the same month in 1993. This positive trend was likely to continue and indicated a revival of consumer spending in 1994 when total real private consumption was estimated to increase by 2.9 per cent.

In response to the income tax cut and provision of liberal loan facilities from the housing banks at low interest rates, housing investment, in particular in owner-occupied units and condominiums, continued to be strong in 1994. The number of new housing construction projects increased by 7.7 per cent in the first quarter and 11.8 per cent in the second quarter over the number observed in the same period of 1993. In 1994 real GDP originating from private housing investment was expected to increase by 3.8 per cent. Public works, in terms of the total value of construction increased by 5 per cent in the first quarter and 7.8 per cent in the second quarter of 1994 over values observed in the corresponding quarters in the previous year. Increases of a similar nature were likely in the rest of the year and were expected to strengthen the economic recovery.

Investment demand for new machinery and equipment decreased continuously from the fourth quarter of 1991 because of the existence of considerable spare production capacity which could not be utilized in the recession period. One other factor inhibiting growth in domestic business investment has been the location of more and more production capacities outside Japan in response to an appreciating yen. As a result of these factors real business investment in 1994 was likely to have contracted by 6.2 per cent. There are however, some indications that business confidence has recently improved.

As a result of the tax cut and other expenditure increases undertaken by the Government to stimulate the economy, the fiscal position in 1994 deteriorated considerably. The budget deficit to GDP ratio was estimated to be 2.7 per cent compared with 0.2 per cent in 1993. However, money supply continued to expand at a low pace. In spite of lower short-term interest rates, loans extended by banks and other financial institutions, except for house-building loans, did not pick up. The growth rate of money supply (M_1) was expected to be 1.5 per cent in 1994 compared with 1.1 per cent in 1993.

In New Zealand, both private consumption and investment increased considerably in 1994. Real private consumption expenditure has been estimated to increase by 3.1 per cent, slightly less than the rate observed in 1993. Retail sales in the first quarter of 1994 were 7 per cent higher than the sales observed in the same quarter of 1993. Big increases were recorded for durables, such as household appliances, cars and furniture, indicating buoyant consumer morale.

Private investment in New Zealand has been increasing fast as business confidence in the economy improved. Real investment, after increasing by 11.2 per cent in 1993, was estimated to have increased by 10.1 per cent in 1994. Investment in residential housing has been a major factor in this strong growth, but investment in non-residential construction, plants, equipment and machinery also contributed substantially.

New Zealand's budget which was in deficit in 1992 recorded a surplus both in 1993 and 1994. Non-priority expenditures have been tightly controlled. Revenue was also buoyant owing to strong economic growth. As a result of the budget surplus, the growth of money supply (M_1) in 1994 was at a low rate of 2.3 per cent.

Inflation

In Australia, the recession of the early 1990s produced a marked reduction in inflationary expectations. Also, in spite of the revival of economic growth, excess capacity still exists in the economy. As a result, the consumer price index increased only moderately in 1994.

Although, as expected, price increases in the early quarters of 1994 have been low, the monetary authorities sensed signs of a boom and were apprehensive of possible increases in inflationary pressures. To neutralize any such pressure the authorities increased the official interest rate by 0.75 per cent in August 1994. This was the first interest rate hike since 1989. The interest rate was again increased in October 1994 by a full percentage point. As a result of these policies in 1994, the consumer price index (CPI) increased by 2.0 per cent which was only slightly higher than the rate observed in 1993.

During 1994, domestic prices in Japan continued to show a declining trend owing to a slow increase in consumption demand and a fall in import prices caused by an appreciating yen.

Nationwide CPI grew by only 0.2 per cent in the first quarter (over the previous quarter) and fell by 0.5 per cent in July. For the entire year of 1994, CPI rose by less than 1 per cent.

In New Zealand, after a slow increase in the first and second quarters of 1994, consumer prices increased substantially in the third quarter by 1.8 per cent over prices observed in the same quarter of 1993. Increases in housing costs, petrol prices and electricity charges were responsible for most of the price rise. Although the quarterly increase of the inflation rate was below the central bank's upper limit of 2 per cent, the monetary authorities estimated that inflationary pressures might further gain strength in the fourth quarter of 1994 and in 1995. To obviate this possibility, monetary conditions were tightened in September 1994 leading to small increases in interest rates. This limited CPI increase in 1994 to 1.5 per cent compared with 1.4 per cent in 1993.

Policy responses

In Australia, short-term policies in 1994 centred around increasing wage rates and tightening the money market. The Industrial Relations Commission agreed to the trade unions' claim for an $A 24 per week "safety-net" wage increase for workers who tried but failed to negotiate wage increases under enterprise bargaining. Although the wage increase will be in phases with very little immediate effect, this could provide an inducement to future wage demands which may not be matched by productivity increases, leading to cost-push inflationary pressure.

The Government of Australia also continued its privatization efforts. In 1994, the Government proposed the privatization of the Federal Airports Corporation. However, the 22 airports under its jurisdiction will be offered on 50-year lease rather than outright sale. Revenue from this deal is expected to reduce the budget deficit.

The recent trend of monetary and fiscal policies of Japan has been expansionary in order to boost the economy during the recession. The Government completed a new package of economic measures in February 1994. The package comprised the following three parts: first, an income tax cut to the tune of $60 billion was proposed to boost demand, supplemented by increased expenditures on public works; second, measures were proposed to promote the effective use of land, assist small and medium-sized businesses and to invigorate the financial and securities market to increase investors' morale. One of the measures has been to ease monetary policy considerably through a reduction of the discount rate from 6.0 per cent in 1991 to an historically low level of 1.75 per cent in 1994; third, steps have been proposed to promote deregulation with an emphasis on increasing imports to widen consumers' choice and to narrow price differentials between Japan and rest of the world. The increased availability of cheap imports, in the wake of an appreciating yen, was expected to increase both real disposable income and the welfare of the consumers and contribute positively to the overall economic performance.

In New Zealand, the Government announced its economic policies at the end of October 1994. The measures included certain changes in both tax rates and expenditures. An increase in the top marginal income tax rate by 3 per cent was proposed and the estate duty has been slightly increased. On the expenditure side increased infrastructural spending on roads, public transport and sewage systems will be effected. A new nationwide community-based work plan with an emphasis on training will be created for the human resources development of unemployed workers. However, expenditure increases in these priority areas were expected to be mainly financed from savings generated by controlling expenditures in other areas.

III. INTERNATIONAL TRADE AND BALANCE OF PAYMENTS

RECENT PERFORMANCE: A REGIONAL PERSPECTIVE

The establishment of the World Trade Organization (WTO) on 1 January 1995, as an outcome of the Uruguay Round of multilateral trade negotiations, is the most important trade-related event of recent years. WTO, as a successor of the General Agreement on Tariffs and Trade (GATT), will oversee the implementation of the agreements on trade in goods, and for the first time, on trade in services. These agreements will have far-reaching impacts on trade, investment and economic growth in the ESCAP region and elsewhere. As noted in chapter I, there have been parallel developments focusing on greater liberalization in various regional trading arrangements. The combination of these processes will have a major impact on trade and the balance of payments of the developing countries of the ESCAP region.

The liberalization of trade in agricultural commodities, one of the outcomes of the Uruguay Round, will have important ramifications, particularly for those developing economies in the ESCAP region which are still dependent upon the exports of primary commodities as the major source of their foreign exchange earnings. While the change will increase market access, it will also introduce unprecedented competition in international markets. Similarly, the inclusion of textiles and garments under the new multilateral agreements, along with across-the-board liberalization of trade in manufactures, promises to open up markets to exports from developing countries through the systematic removal of non-tariff barriers. However, some of the developing countries will lose the privileged market access they had previously enjoyed. The General Agreement on Trade in Services (GATS), while facilitating inflows of foreign investment will place increasing pressure on developing economies to liberalize and open up their service industries to foreign competition.

The developing countries in the region may, therefore, need to adjust their economic policies and strategies to the changed world trade environment. Due consideration needs to be given by Governments to measures to reorient their economies to the emerging competitive conditions in world trade and to take full advantage of the changing conditions which are potentially in their favour. The trade and economic performance of countries in the region in the coming years would depend considerably on their relative capacities to adapt and implement policies to meet the challenges of the emerging external environment successfully.

Against the background of changes in the world trading environment, there have also been important developments during 1994 regarding the establishment of regional and subregional trading arrangements within Asia and the Pacific. By and large, these developments have been motivated by recognition of the increasing importance of intraregional trade. By further strengthening such arrangements and forging closer links among them, the countries of the ESCAP region could more fully utilize the strength and potential of the region through greater intraregional trade and investment flows (see box III.1).

In terms of recent performance, with the exception of the least developed countries, the Pacific island economies and the disadvantaged economies in transition, both the export and import trade of the region remained generally buoyant in 1993 and 1994 (table III.1). The prospects for 1995 remained equally good or better. The strengthening of economic recovery in the industrialized countries, the prospect of world trade liberalization under the auspices of WTO, and the growth of intraregional trade within the Asian and Pacific region, will sustain or give further fillip to the region's already robust trade growth.

In the past year, the least developed countries have extended their policy reforms in the area of trade. In general, they have taken measures to

Box III.1. Some recent developments in subregional trading arrangements

Globally, there has been an increase in the formation and consolidation of formal regional and subregional trading arrangements, even as the Uruguay Round headed towards its conclusion in 1994. (See box I.2 for a discussion of regionalization and multilateralism in world trade). In the Asia-Pacific region, the trend towards regionalization is being advanced by several initiatives, particularly those mounted by the Association of South East Asian Nations (ASEAN) and Asia-Pacific Economic Cooperation (APEC).

The declaration by APEC at its Summit meeting at Bogor in 1994 seeks to establish free and open trade and investment in Asia and the Pacific no later than 2020. The declaration, which developed from a recommendation by an eminent persons group to APEC, urged the establishment of an APEC community committed to free trade. While there have not as yet been any concrete plans for the implementation of the Bogor declaration, a timetable for members to achieve free trade has been enunciated; for developed countries the deadline is 2010 and for others 2020. The declaration also opened the way for other parties to participate in the agreement at a later date. When APEC was conceived five years ago, it was as a loose, consultative body. However, the Bogor declaration has the potential to transform APEC into a formal trading arrangement though its master plan has yet to be fleshed out by its members.

Meanwhile, the ASEAN Free Trade Area (AFTA) has progressed beyond the stage of the drawing board. The formalization of AFTA was a major undertaking of ASEAN in the area of economic cooperation among its member countries. On 1 January 1993, ASEAN formally launched AFTA with the introduction of the Common Effective Preferential Tariff (CEPT) scheme as the main instrument to establish its free trade area.[a] Under the CEPT scheme, intraregional tariffs barriers would be reduced over the projected 15-year period to 5 per cent or less by the year 2008.[b]

All manufactured products, including capital goods and processed agricultural products, and those falling outside the definition of agricultural products are covered by the CEPT scheme. In addition to agricultural products which are excluded from the CEPT scheme, a product might be excluded under two other circumstances: (a) when a product is considered necessary by a member state for the protection of its national security, public morals, human, animal or plant life and health, and articles of artistic, historic or archaeological value (general exceptions); and (b) the CEPT scheme might exclude certain sensitive products on a temporary basis (temporary exclusions).

Two programmes of tariff reduction under the CEPT scheme were established. The normal track would see all tariffs reduced to 5 per cent or less within 15 years. In order to promote commonality of tariff rates among members, the reduction of tariffs below 20 per cent under the normal track would be attained in three tranches: 15 per cent by the year 2003; 10 per cent by 2005; and 5 per cent or less by 2007. The fast track would bring about the reduction of tariffs for 15 selected categories of products to 5 per cent or less within 10 years.

To supplement and complement the liberalization of trade within ASEAN, member states also agreed to explore further measures on border and non-border areas of cooperation. These included the harmonization of standards, reciprocal recognition of tests and certification of products, removal of barriers to foreign investments, macroeconomic consultations, rules for fair competition, and the promotion of venture capital.

Events took a dramatic turn in September 1994 when the ASEAN Economic Ministers Meeting in Chiang Mai agreed to accelerate the AFTA programme by eliminating most of the exclusion items and stepping up its implementation. Under the new schedule, AFTA is expected to be achieved by the year 2003, reducing the gestation period from 15 to 10 years. The exclusion lists would be eliminated by 1 January 2000 while agricultural products would be brought in, with some exclusions.[c] If AFTA keeps to its new schedule, one could expect some significant increase in intra-ASEAN trade from the rather low current level of only 17 per cent of all trade conducted by ASEAN countries (compared with 70 per cent for the European Union). As part of its efforts to enhance the implementation of AFTA, the programme on common classifications, customs procedures and valuation is expected to be completed by the end of 1995.

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[a] Within the free trade area that is eventually established, ASEAN member states would share common effective tariffs among themselves, but tariffs with non-ASEAN countries would continue to be determined by member countries individually. See ASEAN Secretariat, *AFTA Reader*, vol. 1 (1993) for further details of the CEPT scheme.

[b] For the purpose of implementing the CEPT Agreement, the ASEAN Economic Ministers established the AFTA Council composed of Ministers from ASEAN Member States and the Secretary-General of ASEAN.

[c] In order to step up its implementation, an AFTA Unit has been established at the ASEAN Secretariat.

In the wake of these moves by ASEAN and APEC, the member states of the South Asian Association for Regional Cooperation (SAARC) in April 1993 agreed to establish the South Asian Preferential Trading Arrangement (SAPTA). The primary objective of SAPTA, as with other regional trade agreements, is to expand intraregional trade which currently stands at merely 3 per cent of the total trade of the SAARC members.

The agreement which has yet to be ratified by all parties relies on tariff reductions on a product-by-product basis rather than an across-the-board action. The envisaged reductions in tariffs would take place in successive stages with periodic reviews. The first round of negotiations is projected to cover primary products, agricultural and extracted raw materials, livestock, marine products, scrap metals and manufactured products with less than 50 per cent foreign content.

One of the difficulties facing the SAARC countries in the implementation of SAPTA is the manner in which tariff reductions will be negotiated over time. The product-by-product approach is likely to be time-consuming and may not have a significant impact upon intraregional trade in the short and medium term. In order to hasten the pace of intraregional trade it may be more appropriate to pursue an across-the-board preferential trade agreement, including agreements on transit and overland trade.

The eventual impact of AFTA and SAPTA will be conditioned by the final form in which the APEC vision is realized. If the targets of achieving free and open trade and investment in Asia and the Pacific no later than 2020 are realized, then regional trading arrangements, such as AFTA and SAPTA, may have to reassess their roles within a greatly altered trading environment within the region.

relax foreign exchange controls further to permit the exchange rates to reflect market rates, to reduce import duties, and to replace rigid quota systems with more transparent tariff systems. The least developed countries also continued efforts to diversify their exports. Bangladesh, for example, has been able to reduce dependence on traditional exports of jute and jute products because of success in the export of ready-made garments, frozen fish and shrimps. For most other least developed countries, export earnings have been dominated by a few primary commodities.

Economic recovery in the industrial countries and a recovery in the level of most commodity prices in 1993-1994 is expected to boost export earnings of the least developed countries and the Pacific island economies at least in the short term if supply bottlenecks do not turn out to be binding constraints. Although the value of some of the special treatments they have received, such as under the Lomé conventions, might be eroded, the liberalization of trade in goods and services resulting from the Uruguay Round may provide them enhanced opportunities for market access. To take advantage of those opportunities major improvements in supply capability through the strengthening of infrastructure and the development of human resources are required.

The pattern of foreign trade at present for the Central Asian republics leans heavily towards traditional trade links with the Commonwealth of Independent States (CIS), although trade with non-CIS countries is growing in importance. By now, practically all the republics have introduced national currencies. But no new payments mechanism, particularly for trade with CIS countries, is in place. This has resulted in the development of what is essentially a bilateral form of trade which has, at times, taken the form of barter transactions. The Central Asian republics as a group experienced a drop in export earnings of close to 14 per cent in 1993, while imports rose by just over 2 per cent. With the exception of Kyrgyzstan and Tajikistan, all other Central Asian republics experienced a sharp fall in export receipts.

Economic recovery in the developed countries and strong growth in intraregional trade provided a stimulus to the growth of trade in the East Asian economies. Economies of the subregion have been able to sustain their exports by means of rapid diversification from labour-intensive consumer goods to higher value-added electronic equipment and consumer durables. The electronics industry of the East Asian economies has maintained its leading role in exports despite having to endure slashed profit margins. In fact, the relocation of electronics manufacturing from various industrial centres to the developing countries in the region was one of the major impulses for the expansion of intraregional trade in East Asia.

Table III.1. Total value and annual rates of change in the dollar value of merchandise exports and imports, 1991-1994

(Millions of US dollars)

	Exports					Imports				
	Value	(Annual rates of change) percentage				Value	(Annual rates of change) percentage			
	1993	*1991*	*1992*	*1993*	*1994[a]*	*1993*	*1991*	*1992*	*1993*	*1994[a]*
Economies in the ESCAP region	994 783	14.6	11.1	8.2	..	913 963	10.0	6.8	8.4	..
Developing economies in the ESCAP region	579 250	19.6	14.3	9.9	..	617 197	16.5	10.9	10.9	..
Least developed economies										
Bangladesh	2 273	1.1	24.2	8.3	7.1[b]	3 989	-8.2	16.6	2.1	-1.6[b]
Bhutan	66	-4.0	-12.5	4.8	..	125	-5.6	-18.6	50.6	..
Cambodia	213	147.7	24.4	-19.6	..	392	49.4	43.3	11.7	..
Kiribati	4	0.1	66.5	-16.3	..	26	-3.7	42.3	-29.7	..
Lao People's Democratic Republic	147	-22.6	16.8	11.4	..	319	5.8	-9.2	20.4	..
Maldives	35	3.8	-25.9	-12.5	..	191	16.7	17.4	1.1	..
Myanmar	585	28.9	26.7	10.2	38.5[b]	814	139.3	0.8	25.0	11.0[b]
Nepal	435	25.8	42.2	16.3	14.0	887	11.5	3.5	12.0	13.1
Samoa	6	-33.3	0.0	0.0	-33.3[b]	105	16.0	17.0	-4.5	-24.2[b]
Solomon Islands	96	18.6	21.7	-5.0	..	101	15.8	-11.8	4.1	..
Pacific										
Fiji	407	-9.5	-3.3	-6.4	6.9[b]	634	-13.5	-4.3	1.6	10.6[b]
Papua New Guinea	2 484	24.0	22.6	38.8	3.5[b]	1 299	27.1	-5.8	-14.6	19.1[b]
Tonga	17	18.2	-7.7	41.7	..	61	-4.8	6.8	-3.2	..
Central Asia										
Armenia	29	..	..	141.7	..	85	..	..	41.7	..
Azerbaijan	351	..	136.1	-53.5	..	241	..	-58.8	-27.6	..
Kazakhstan	1 271	..	80.2	-9.1	..	358	..	-71.5	-23.7	..
Kyrgyzstan	112	..	67.8	46.4	..	112	..	-87.4	58.9	..
Tajikistan	263	..	-60.2	137.4	..	374	..	-71.1	182.9	..
Turkmenistan	1 049	..	-3.5	-8.4	..	501	..	35.9	-7.7	..
Uzbekistan	707	..	34.1	-18.6	..	947	..	-29.9	1.9	..
Other developing economies										
East Asia										
China	91 737	15.2	18.0	8.1	24.9	103 881	18.6	26.2	28.9	14.1
Hong Kong	135 248	20.0	21.2	13.2	16.3	138 658	21.6	23.1	12.3	16.6
Mongolia	381	-0.3	11.8	-2.1	..	362	-26.0	15.8	-13.4	..
Republic of Korea	82 189	10.6	6.7	7.3	13.8	83 784	16.9	0.4	2.4	18.0
South-East Asia										
Brunei Darussalam	2 282	21.1	-12.2	-3.7	..	1 247	15.5	-0.2	6.0	..
Indonesia	33 612	15.1	14.6	-0.7	11.7	28 086	18.5	5.6	2.8	12.6
Malaysia	47 122	16.6	18.7	15.6	24.7	45 657	25.3	8.7	14.6	28.5
Philippines	12 930	7.4	10.9	32.6	18.0	17 271	-1.4	20.3	11.7	21.0
Singapore	74 006	11.8	7.6	16.7	21.3	85 230	8.8	9.1	18.2	17.1
Thailand	37 173	23.2	14.2	14.5	19.1	46 058	13.6	8.3	13.2	16.5
Viet Nam	2 850	-13.2	18.6	15.2	27.0	3 415	-15.0	7.2	36.3	23.4

(Continued on next page)

Table III.1 *(continued)*

(Millions of US dollars)

	Exports					Imports				
	Value	(Annual rates of change) percentage				Value	(Annual rates of change) percentage			
	1993	1991	1992	1993	1994[a]	1993	1991	1992	1993	1994[a]
South Asia										
India	21 554	-1.4	10.8	9.7	15.5	22 763	-13.3	15.4	-3.5	12.7
Iran (Islamic Republic of)	16 467	-4.6	4.7	-14.6	5.5	14 118	36.2	-15.3	-33.3	0.2
Pakistan	6 672	17.0	12.5	-8.3	3.2	9 481	15.0	10.7	1.2	3.2
Sri Lanka	2 792	2.8	24.3	14.3	14.0	3 732	17.1	10.6	9.4	10.7
Developed economies in the ESCAP region	415 538	8.9	7.1	5.8	4.9	296 766	0.1	-0.4	3.7	8.7
Australia	42 715	5.3	2.4	-0.3	4.3	45 478	-0.9	5.2	3.8	10.5
Japan	362 286	9.6	7.9	6.6	4.9	241 652	0.8	-1.7	3.6	8.3
New Zealand	10 537	2.7	2.0	7.1	9.1	9 636	-11.5	9.6	4.5	8.4

Sources: United Nations, *Monthly Bulletin of Statistics*, vol. XLVIII, No. 12 (December 1994) and *Project Link World Outlook* (November 1994); Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries*, vol. XXV (Oxford University Press, 1994); and national sources.

[a] Projection/estimates. [b] Figures for half the year only.

Exports to China from the countries of the East Asian subregion have been boosted by the strong economic growth of China and its expanding economic linkages in Asia. Direct investment in China originating from other East Asian economies surged in 1994 and helped to generate an expansion in the export of capital goods and manufactured inputs from these economies to China. Trade with China was also reinforced by policy reforms in China which lowered tariff rates, eliminated many non-tariff barriers and allowed its currency to move towards convertibility. Overall, China's imports expanded by more than 25 per cent annually during the period 1992-1993. A growing share of this flow of imports came from other East Asian and South-East Asian economies.

The strong economic performance of all the major economies in South-East Asia is directly linked to the impressive growth of their export sectors. In these economies export growth in 1994 exceeded that of 1993 with manufactures exports dominating in most. In Brunei Darussalam and Viet Nam, exports of primary commodities remained predominant. High rates of growth in exports were partly responsible for the high growth in imports which exceeded 10 per cent in 1994 in all the countries. In 1993 and 1994, Indonesia and Malaysia maintained their usual surpluses on their merchandise trade accounts, while the rest of the South-East Asian economies incurred deficits. Singapore was the only country in this group which had a surplus on its goods, services and income transfers account. The Philippines, Thailand and Viet Nam faced substantial balance-of-payments deficits on goods, services and income. Large inflows of capital have kept the overall balance of payments of all these countries in surplus in recent years and helped reserve levels to rise.

The external sector reforms in the South Asian countries have been largely responsible for the increase in trade and capital inflows which have helped to contain their deficits on current transactions and to build up reserve levels. The trade performances of countries have not been even and no uniform pattern in the growth of exports and imports is discernable. Although these countries generally recorded positive growth rates in both exports and imports, substantial variations are noticeable within countries over time.

With wide-ranging reforms that encompassed both the domestic and the external sectors of the economy, the South Asian countries have succeeded in maintaining macroeconomic and exchange rate stability while building up their foreign exchange reserves. Capital inflows in most countries have improved significantly. Liberalized investment policies and incentives along with the stable economic environment have brought substantial amounts of non-debt-creating capital inflows.

MERCHANDISE TRADE

The least developed and Pacific island economies

The latest available statistical indicators do not suggest that the least developed or the island economies have been able to overcome the basic problems of their external trade sector. Export earnings, narrowly sourced and small in volume, continued to fluctuate without any firm trend over time. The diversification of the export trade, being attempted by most of them through simple processing of products, such as textiles, faces mixed prospects, as international trade in textiles and apparel is thrown open to competition with the implementation of the Uruguay Round of multilateral trade agreements including the phasing out the Multifibre Arrangement that has governed international trade in textiles and apparel since the 1960s (see box III.2). Import capacities remained crucially dependent on the availability of official development assistance (ODA). The access to foreign private capital remained very limited. Bangladesh, Myanmar and Nepal, the most populous among the least developed countries, and Papua New Guinea, the largest of the Pacific island countries, have shown a degree of resilience in the export sector since 1990 with their efforts at reforms of the trade and exchange systems.

Exports from Bangladesh grew by more than 8 per cent in 1993 decelerating from above 24 per cent in 1992. They were led by ready-made garments which comprised 52 per cent of total exports. In addition, exports of frozen shrimp and frog legs, another non-traditional item, rose by 26.8 per cent. Receipts from the traditional exports of jute and jute products fell by around 5 per cent. Imports rose by 2 per cent, the main increase occurring in imports of textiles which were utilized as an input for garment production. In addition, steady growth was registered for the import of capital goods, and intermediate goods such as cement and fertilizers. Data for the first half of 1994 indicated a 7 per cent growth in exports and a 2 per cent fall in imports over the same period of 1993.

In Bhutan, exports continued to depend on India as the major market which accounted for more than 90 per cent of the total. The most significant export from Bhutan to India is the sale of electricity from the Chukha Hydroelectric Plant. After falling in the previous two years, the value of exports rose by about 5 per cent in 1993. At the same time total imports, which consisted mainly of petroleum products, rice and electrical equipment, grew by more than 50 per cent over the previous year.

The total exports of Cambodia declined by about 20 per cent after the two previous years of high growth. The country continued to rely on primary commodities for its exports. Cambodia's main imports, however, as in many least developed countries, comprised industrial goods such as machinery, transport equipment, and consumer durables. A steady increase in imports has contributed to the substantial deterioration in the external deficit.

The Lao People's Democratic Republic improved its export performance substantially in 1992-1993. While the country's exports continue to be dominated by natural resources such as timber and hydro-electric power, the influx of foreign direct investment (FDI) in recent years has enabled the Lao People's Democratic Republic to develop some manufacturing-based export industries, such as garments, by taking advantage of the country's cheap labour. In spite of the good performance of exports, the trade balance deteriorated in 1993 owing to the faster growth in imports which mainly consisted of machinery, raw materials and petroleum.

The exports of Maldives declined for the second consecutive year in 1993. This decline in exports was mainly due to reduced demand for the country's exports of canned and frozen fish as the supply of these items from other foreign competitors had increased. Imports have traditionally been very high because the country imports most of its daily necessities. The recent rapid increase in imports, resulting from liberal macroeconomic and import policy measures was halted in 1993, when import growth was curbed to only 1.1 per cent to contain the trade deficits.

Box III.2. Multifibre Arrangement (MFA) and beyond

The planned re-integration of world trade in textiles and apparel into the General Agreement on Tariffs and Trade (GATT) through a 10-year phase-out of the Multifibre Arrangement (MFA) was a major achievement of the Uruguay Round. The interest of the developing countries in the trade liberalization it promises is easily understandable, given the key role that the textiles sector played in the economic development of western developed countries in the nineteenth century, of Japan during the inter-war period, and of the newly industrializing economies since the early 1960s. For many developing countries, textiles and apparel provide a major source of their export receipts; thus, for Pakistan, the share of textiles and clothing in such receipts is over 75 per cent. Yet, for more than three decades, textiles and apparel have arguably faced the most persistent trade restrictions among all manufactures. A more liberal world trading system can help developing countries to gain comparative advantage in this sector and thereby realize its full development potential.

Although the MFA was a multilateral agreement, its operational contents were contained in a series of bilateral "voluntary" export-restraint agreements negotiated between the importing and supplying countries within the norms established by MFA. The European Community, however, negotiated these agreements as a group with individual supplying countries and then allocated import quotas to its members. While the first multilateral coordination of protection in this sector in the early 1960s[a] was directed only at cotton textiles products, the major trading nations expanded coverage of such coordination to man-made fibre products when the first MFA was negotiated in 1974 under GATT, but outside its normal discipline. MFA was renewed in 1977, 1981 and 1986. MFA-IV, originally scheduled to expire in 1991, ran out its course at the end of 1994, with all the restrictions under it to be carried over and maintained until they are eliminated under the terms of the new agreement reached in the Uruguay Round.

The cornerstone of MFA was the concept of "market disruption" introduced by GATT in 1960. This allowed an importing country to introduce trade-restricting measures in the event of an import surge associated with low import prices not related to dumping or foreign subsidies. Such measures could be taken on the basis of a potential, rather than any actual, damage[b] to a domestic industry, and could be applied against individual countries responsible for the import surge. There was no need to apply them on a non-discriminatory most favoured nation (MFN) basis. MFA set a precedent of applying trade quotas selectively against exporting countries, which, in practice, mostly affected developing countries. It also departed from the general GATT principle of relying, for the purpose of trade protection, on tariffs rather than on quotas.

As MFA evolved, it grew more restrictive. MFA-I contained a number of relatively liberal features: a provision for a 6 per cent annual quota growth, and a certain degree of quota flexibility that allowed, *inter alia*, the transfer of quotas across product categories ("swing" provision), export against a future year's quota ("carry forward" provision) and a carrying over of unused quotas to subsequent years' imports ("carry-over" provision). Subsequent renewals of MFA, however, brought increasing restrictiveness into the arrangement through the reductions of quotas, "reasonable departures" from the standard 6 per cent quota growth rate, and the denial of flexibility through the swing and other provisions. Furthermore, the coverage of MFA was expanded to textiles made of ramie, silk blends, linen and vegetable fibres. It may be noted that the quota restrictions under MFA were in addition to the normal MFN tariff.[c]

At the end of the 1980s, there were 43 signatories to MFA representing 54 countries. While MFA covered about one fourth of world trade in textiles and apparel, the coverage was much higher for apparel (40 per cent) than for textiles (14 per cent), reflecting the larger role of developing-country suppliers in apparel than in textiles. In some importing countries, as much as 80 per cent of the imports of textiles and apparel from developing countries was subject to MFA-quotas. The product categories subject to restrictions varied between supplier countries; typically, the larger a supplier, the larger the number of product categories which faced restrictions.

The Uruguay Round agreement on textiles and apparel provides for a sequential elimination of product coverage: by 1 January 2002, 51 per cent of 1990 imports (in volume) will be made free of quota restraints in three phases, with the remaining 49 per cent to be made so by the end of the transition period on 1 January 2005. As products are progressively integrated into GATT, the quota for each product that still remains

[a] Short Term Arrangement (1961) and Long Term Arrangement Regarding Cotton Textiles (1962).

[b] As required under normal GATT safeguard provisions in article XIX.

[c] In 1987, the average nominal tariff on apparel in the United States was 22.5 per cent, and for textiles and apparel as a whole, it was 11.5 per cent reflecting a lower tariff for textiles in which the developed countries have greater competitiveness. Quotas also drive a wedge between domestic and world prices by restricting supplies, the difference being called the "tariff equivalent" of a quota. Estimates of tariff equivalent of MFA-quotas vary, with 20 per cent being cited as a reasonable approximation for the United States.

(Continued overleaf)

(Continued from preceding page)

under quota at any stage of the phase-out must be increased at an annual rate greater than that allowed in the previous stage. The annual growth rate of quotas in stage 1 will be no less than 16 per cent greater than that in force in 1994.[d] For stage 2 and stage 3, the annual growth rate must be, respectively, no less than 25 and 27 per cent greater than in the previous stage. The effect of this provision on developing-country exporters will vary, countries with high initial growth rates benefiting the most. The agreement also provides for a transitional safeguard mechanism that seems to have caused some concern to developing exporting countries. This allows an importing country to impose, on the basis of a perceived threat of damage, restrictions on individual exporting countries that can remain in place for up to three years without extension. No prior consultation is required for such action.

The impact of the elimination of MFA will be felt only over time because of the staggered nature of its implementation. It is generally agreed that the phase-out will give a boost to world trade in textiles and apparel, although the trade environment will be characterized by much stiffer competition which some developing countries may find problematic. Most model-based estimates show that the developed-country consumers will perhaps benefit most through lowered prices. On the export side, developing countries able to compete successfully will gain from the absence of quota restrictions, but will lose "quota rents" from the higher prices that they received under MFA because of quota-restrained supply. At any rate, it is clear that the post-MFA era will witness significant adjustments in market strategy, product mix and use of technology in the apparel and textile industry. Many developing countries will be required to increase their competitiveness in order to hold on to their shares in world trade.

[d] If, for example, the current growth rate is 10 per cent, a 16 per cent increase in the growth rate would mean an elevated growth rate of 11.6 per cent.

Exports from Myanmar have been rising rapidly since 1990. In 1993, however, the rate of growth moderated to about 10 per cent over the previous year. Whereas rice exports have continued to grow steadily, there was a decline in exports of teak wood and products because of government restrictions on logging activities. Imports, which largely consisted of raw materials and capital goods, rose by 12 per cent in 1993.

The total exports of Nepal grew by more than 16 per cent in 1993, a significant achievement in the wake of a growth rate of 42 per cent recorded in the preceding year. Through recent product and market diversification efforts, the country has achieved a breakthrough in exporting garments and carpets to other countries, reducing its traditional dependence on the Indian market. A recent agreement between Nepal and the United States of America allowing Nepalese carpets duty-free access to the United States market could assist in further diversification. Imports recorded a growth rate of 12 per cent in 1993 and were estimated to grow by 13 per cent in 1994. But for an increase in the cost of imports following currency devaluation and a slack in foreign investment inflow, import growth could have been higher as the import regime had been substantially liberalized.

The least developed countries and Pacific island economies rely heavily on the exports of primary commodities. Their export performance, therefore, is highly sensitive to the vagaries of nature which affect the domestic supply, and to fluctuations in demand and prices of the commodities in the world market. A number of these countries were hit by cyclones which adversely affected production and exports in 1993. The movement of the international prices of Pacific island agricultural exports was not uniform. There were some improvements in the prices of coffee, beef and fish, and log prices reached high levels reflecting the general shortage of logs on the world market. Prices of cocoa, and palm oil and kernel remained unchanged from their 1992 levels, while those of coconut products declined. As for the non-agricultural products, the gold price increased to its high level of 1991 while the price of copper has remained depressed since 1991. The varying supply and price movements affecting individual commodities were reflected in the volatility of movements in the island economies' exports.

Among the least developed Pacific island countries, Kiribati's exports, valued at $4 million in 1993, marked a decline by more than 16 per cent over the previous year. The decline in exports of copra and marine products was caused by the decrease in world demand and an increase in competition from other suppliers of these commodities.

The total exports of Samoa, a least developed Pacific island country, was valued at $6 million in 1993. During the two years since a major drop in 1991, the country's exports remained stagnant. The destruction of primary commodities caused by successive cyclones brought about the decline. Taro, which is one of the major export commodities of the country, was also affected by the disease called taro-leaf blight.

The exports of Solomon Islands fell by 5 per cent in 1993 to $96 million after an average growth of 20 per cent over the previous two years. This increase was predominantly led by logging activities and the extraction of other forest resources, raising concerns about sustainability. Consequently, the Government has attempted to: (a) reduce the dependence on logging activities for fear of exhausting the resources, and (b) to diversify exports.

In Tuvalu, export earnings have declined steadily because of the fall in supply and prices of fish. Vanuatu's principal export items (copra, beef, kava, coffee, timber and, more recently, squash) similarly suffered from a supply and price decline.

Imports, although small in absolute terms, are several multiples of the value of exports in many of the least developed countries. The dependence on other sources for financing the deficits is thus obvious.

Fiji's exports have suffered a continuous decline over the period 1991-1993, but there were indications of an upturn in 1994. A largely similar pattern was observable for imports.

Papua New Guinea's exports increased by 39 per cent in 1993 following two previous years of rapid growth. Much of it was accounted for by oil with production at Kutubu oil fields coming on full stream. Proceeds from oil accounted for 34 per cent of total exports receipts while earnings from gold exports contributed the next highest share with 28 per cent. Revenue from forest products, especially logs more than doubled in 1993 and contributed 17 per cent of total exports. The share of agricultural products, mainly coffee and palm oil, was only 10 per cent. While exports increased at high rates, imports decreased producing a substantial surplus in the trade balance. The lower level of imports was mainly due to reduced imports by the mining and petroleum subsectors.

Tonga's exports, valued at $17 million in 1993, consisted mainly of coconut products and bananas which have since been replaced by squash (48 per cent) and vanilla (16 per cent) as the major items. The country recorded a high growth rate of exports in 1993, but its potential has suffered owing to the decline in the prices of copra and the virtual elimination of the banana industry. The performance of squash has been remarkable since it was first exported to Japan in 1990.

Central Asia

As could be expected from their overall economic situation, the trade performance of the Central Asian economies remained generally unsatisfactory. According to available information, the volume of trade (expórts and imports) in Armenia in the first half of 1994 reached $138 million, of which $90 million was accounted for by trade with the CIS countries. Almost 80 per cent of this trade was conducted by public enterprises. Cut and uncut diamonds, machinery and equipment, electrical appliances, and shoes were main export items. Food imports made up nearly half of total imports.

Azerbaijan experienced a massive downturn in trade during 1993; exports fell by nearly 54 per cent while imports fell by almost 28 per cent. Despite this fall in exports, the balance of trade remained in surplus. There is optimism that the eventual development of three offshore oil deposits by a consortium of seven multinational oil companies headed by British Petroleum will strongly boost exports. During the first half of 1994, trade with non-CIS countries, such as the Islamic Republic of Iran and Turkey, appeared to be recovering.

Kazakhstan experienced a moderate decline in exports in 1993 and a sharp drop in imports leading to a surplus in its merchandise trade balance. In common with the other Central Asian republics, the focus of trade in Kazakhstan was shifting away from the CIS to non-CIS countries. Trade with the non-CIS countries remained in surplus during the first two quarters of 1994, although exports declined and imports increased. However, Kazakhstan's trade balance with its CIS trading partners was in deficit.

In 1993, Kyrgyzstan's exports and imports registered a sudden increase and appeared to have been balanced at a value of $112 billion for both. During the first six months of 1994, import payments exceeded export receipts. In particular, exports to non-CIS countries were estimated to have been significantly lower than during the same period in the previous year.

Tajikistan had experienced strong growth in both exports and imports in 1993 after the slump in the preceding year. Imports, however, grew more rapidly than exports and were valued at $374 million and $263 million respectively. Tajikistan relied very heavily on exports of aluminium and cotton. A deficit was recorded in trade with both CIS and non-CIS countries in 1993 and the pattern appeared to have continued in 1994.

In 1993, Turkmenistan experienced a moderate fall in both exports and imports and ended the year with a substantial surplus on the balance of trade. Both exports and imports continued their downward trend in 1994. Exports fell faster than imports, but the balance of trade still remained in surplus. Trade with the CIS countries was adversely affected by defaults in payment on the part of some of the CIS trading partners.

Exports from Uzbekistan in 1993 fell by about 19 per cent. Import growth was a modest 2 per cent. Preliminary data for the first half of 1994 suggested that exports to non-CIS countries increased by as much as 18 per cent. The country's main export items, cotton, chemical fertilizers and non-ferrous metals, were shipped primarily to Germany, Japan, the Netherlands, Switzerland, United Kingdom and the United States. Wheat, sugar, machinery and equipment were the country's principal imports. Trade with the CIS countries also remained significant during 1993 and the first half of 1994. The commodity structure of this trade was similar to its external trade with non-CIS countries.

Other developing economies

East Asia

The major exporting economies of East Asia continued to maintain substantial growth in their exports and imports in the 1993-1994 period. While the pace of export growth had decelerated in 1993 for China and Hong Kong, it remained stable for the Republic of Korea. However, there were clear indications of an acceleration in the growth of exports of these economies in 1994.

The foreign trade (exports plus imports) of China reached $196 billion in 1993, making it the world's eleventh biggest trading nation. Exports rose by just above 8 per cent in 1993, after a growth of 18 per cent in 1992. During the first eight months of 1994, exports had increased by 31.5 per cent over the same period of 1993; for the whole year the estimated increase was about 25 per cent.

China ran its first trade deficit since 1989 with a 29 per cent growth in imports in 1993. Two consecutive years of above 13 per cent GDP growth had generated a considerable increase in demand for capital equipment and industrial raw materials. Imports of machinery and electrical products accounted for 47.6 per cent of total imports. In order to contain the trade deficit, the growth in imports had to be moderated; for 1994, the rate of growth was estimated to have slowed down to 14 per cent. The devaluation of the yuan renminbi by 33 per cent, implemented in January 1994, as a currency reform measure, also helped slow down the growth of imports.

The economic recovery in industrial economies together with the continued appreciation of the Japanese yen enabled the Republic of Korea to improve its export performance significantly in 1994. After a moderate growth of about 7 per cent in 1992 and 1993, exports from the Republic of Korea grew by almost 14 per cent in 1994. Machinery, electronics, shipbuilding, industrial and chemical products led export growth. Imports, which consisted largely of capital equipment, expanded by 2.4 per cent in 1993 but accelerated to 18 per cent growth in 1994.

The imports and exports of Hong Kong generally move in tandem reflecting Hong Kong's entrepôt role. Total exports and imports grew by 13 and 12 per cent respectively in 1993, slower than their respective 21 and 23 per cent growth rates in 1992. In 1993, machinery imports for the large port and airport construction projects had caused imports to rise faster, a pattern that continued in 1994. In the first five months of 1994, export earnings had risen by 8.6 per cent and imports by nearly 11 per cent. Estimates for the whole year showed about 16 per cent growth in both exports and imports.

After a positive growth of both exports and imports in 1992, Mongolia's foreign trade slipped back in 1993. Exports valued at $381 million in 1993 showed a small 2 per cent decline, while imports valued at $362 million had a larger fall of 13 per cent. Non-ferrous metals accounted for 40 per cent of exports, while petroleum products accounted for 30 per cent of imports in 1993. The foreign trade turnover continued to decline early in 1994 because of adverse price movements for two major export items, copper and cashmere, and low volumes of animal-based exports.

South-East Asia

With the exception of Brunei Darussalam, all other economies of South-East Asia generally have continued to enjoy booming trade in recent years. Brunei Darussalam's exports consisted almost entirely of oil and gas which together accounted for about 97 per cent of total exports in 1991. Total exports in value terms have declined over time owing to falling oil prices. The Persian Gulf crisis raised oil prices, which in turn had boosted exports in 1991. The subsequent downward trend in oil prices led to a decline in exports in 1992 and 1993. The major destination of exports from Brunei Darussalam has been Japan, which accounted for about 65 per cent of total exports of oil and gas in 1991. Imports were quite diversified and high per capita income has contributed to their steady increase over a long period. Imports had apparently stagnated in 1992, however they grew by a 6 per cent growth in 1993.

Indonesia has been quite successful in diversifying exports, reducing its dependence on oil and gas exports over time. The country's export trade seemed to have suffered a slack in 1993 when growth in exports turned negative as against a 14.6 per cent growth in 1992.[1] Slow growth in both oil and gas as well as other exports (excluding wood products, paper and steel) contributed to the slow-down. In 1994, a sharp upturn in exports came about with an estimated growth of around 12 per cent. Imports increased by 2.8 per cent in 1993 as against 5.6 per cent in the previous year. Imports of consumer and intermediate goods were higher but slower growth in the import of machinery and capital goods resulted in the moderation of growth in total imports. The deregulation packages announced by the Government in June and October 1993, which introduced phased import tariff reductions, removed tariffs on some commodities important for exports, and relaxed regulations on automotive imports, caused a surge in imports which grew by more than 12 per cent in 1994.

The strong performance of the Malaysian economy is directly linked to the impressive performance of its export sector. Exports have grown at an average of 17 per cent annually over the period 1991-1993. The rapid expansion of manufacturing exports (constituting about 78 per cent of total exports) sustained export growth as earnings from commodity exports, including crude petroleum fell. Exports of electrical machinery and electronic products increased significantly and as a group they are now the single largest foreign exchange earner. Exports of textiles, clothing and footwear expanded at a more moderate pace, partly because of strong competition from other low-cost producers. Growth in exports accelerated in 1994 and was estimated to have reached almost 25 per cent. Strong domestic demand and high growth rates of manufactured exports have also kept the rate of growth of imports high. Imports grew by more than 14 per cent in 1993 as against nearly 9 per cent in 1992. Imports of intermediate goods and investment goods, constituting more than 80 per cent of total imports, grew sharply. Imports of consumer goods grew moderately. Imports of lumpy investment goods – 9 aircraft and 2 liquefied natural gas tankers – also contributed to higher import growth in 1993. Growth in imports accelerated to an estimated 28 per cent in 1994.

Despite the appreciation of the peso, merchandise exports of the Philippines were estimated to grow by 18 per cent in 1994 after a surge of 32.6 per cent in 1993. Semiconductors remained the country's top export commodity. Major increases were recorded in the export of electronics, garments, machinery and transport equipment, mineral products particularly gold bullion, shrimps and prawns, and fruits and vegetables. The appreciation of the peso, partly caused by inflows of short-term capital, remained a cause of concern as it could have an adverse effect on export growth. Merchandise imports were estimated to increase by 21 per cent in 1994 after two previous years of high growth averaging 16 per cent. Some of the increase in 1994 could be attributed to imports of power generation equipment. Other imports recording major increases included telecommunications equipment, materials and accessories for the manufacture of electrical equipment, chemicals, textile yarn, fabrics and made-up articles. Overall the pace and pattern of growth in trade reflected the recovery of the country's economy that has been underway during the past two years.

In Singapore, the rapid economic growth recorded in both 1993 and 1994 was driven mainly by the strong performance of exports, particularly consumer electronics. Total merchandise exports grew by 16.7 per cent in 1993 as against 7.6

[1] National data sources reported on a fiscal year basis, however, indicate higher rates of growth in 1993 than is reflected in the data reported here.

per cent in 1992. Exports grew even faster, estimated at 21.3 per cent in 1994, propelled by the recovery in the United States economy, Singapore's largest export market. The European Union, Hong Kong, Japan, Malaysia and the United States were Singapore's top five external markets. The buoyancy of other neighbouring Asian economies benefited Singapore's export growth. Merchandise imports also have been growing at high rates in tandem with exports since Singapore's exports have a high import content. Furthermore, the higher income growth has been contributing to increased imports. Imports were estimated to grow by a further 17 per cent in 1994 after 18 per cent growth in 1993.

Buoyant export growth has been one of the major factors behind the sustained high growth of Thailand's economy in recent years. Exports grew by 14.5 per cent in 1993 and by 19 per cent in 1994. It is noteworthy that exports for the first time surpassed the figure of one trillion baht in 1994. The main impetus for growth came from relatively high-value manufactures, such as electrical appliances, television sets, plastics, integrated circuits and computer parts. Exports of gems and jewellery, canned seafood and canned pineapple have also increased rapidly in recent years. More than 75 per cent of exports consisted of manufactured goods. Lower prices reduced the exports of agricultural products in value terms but they were recovering in 1994. Total imports went up by 13 per cent in 1993 and were estimated to rise at an accelerated rate of 16.5 per cent in 1994. Rising investment demand has sustained the pace of imports of capital goods, intermediate products and raw materials.

The exports of Viet Nam mainly consisted of primary commodities such as rice, crude oil, marine products, rubber and coffee. Rice and crude oil accounted for about 50 per cent of total exports. Some manufactured goods such as textiles and garments have also been exported recently. Total exports in value terms were estimated to grow by 27 per cent in 1994 compared with an increase of 15.2 per cent in 1993. Most of the increase in export receipts resulted from larger volumes of the exports of primary commodities. Viet Nam has been able to enhance its production of rice substantially in recent years and is now the world's third largest rice exporter. Viet Nam's main trading partners in 1993 were Hong Kong, Japan, the Republic of Korea and Singapore, which accounted for more than 60 per cent of its exports and imports. With the lifting of the United States's economic embargo, a greater product and market diversification of trade is expected in the future. As with exports, imports have also been rising substantially in the wake of economic liberalization and were estimated to grow by more than 23 per cent in 1994 after a 36 per cent growth in 1993. Import quotas have been largely eliminated and the Government has begun to liberalize its system of import permits and licenses. As a result of increasing foreign direct investment, the import of machinery, intermediate inputs and raw material has been rising fast.

South Asia

Exports from India increased steadily through the period 1992-1994 from a decline in 1991. After 9 to 10 per cent rates of growth in 1992 and 1993, the rate of growth of exports was estimated to accelerate to almost 16 per cent in 1994. Exports of agricultural and marine products, leather goods, engineering goods, textiles and garments, and gems and jewellery contributed significantly to the overall growth. During the 1990s, there has been a significant shift in the destination of India's exports. The share of developing countries in India's exports increased, reflecting the vigorous efforts of Indian exporters to exploit market opportunities in the developing countries, especially in the Asian-Pacific region, and a restructuring of India's trade with the former centrally planned economies. Total imports, after a sharp increase in 1992, declined in 1993. This was caused by a drop in bulk imports that included certain categories of consumer goods, raw materials, and intermediate goods including petroleum. The import of capital goods, however, registered a sharp increase. Imports in 1994 were estimated to increase at an accelerated rate of almost 13 per cent.[2]

In the Islamic Republic of Iran, foreign exchange receipts from merchandise exports declined in 1993 from their level in the preceding period largely because the value of oil exports decreased as a result of the sharp decline in prices. However, the value of non-oil exports recorded a steep increase over the same period. Although oil was the Islamic Republic of Iran's dominant export product, non-oil exports of both

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[2] Rates of growth in exports and imports reported here on the basis of the latest revised data published by the United Nations differed significantly from those in national sources reporting data on fiscal year basis. The reported rates of growth in those sources in 1993, for example, are 20.4 per cent for exports and 4.3 per cent for imports.

manufacturing and handmade products (carpets etc.) have been gaining strength. The country is pursuing an export diversification policy with more vigour in order to reduce the economy's vulnerability to fluctuations in oil prices. The value of imports of goods also fell in 1993 as imports were cut back sharply. Over time, the structure of imports has also changed. The share of imports of basic goods has fallen owing to the substitution of imported products with domestic output. However, the share of imports of producer goods, consisting of intermediate inputs and capital equipment, recorded substantial increases. The share of capital goods in total imports in 1993 was about 26 per cent.

After a significant drop in 1993, the export earnings of Pakistan were estimated to have grown by 3.2 per cent in 1994. The failure of the cotton crop, which was an important export item, together with international recession contributed to the decline in 1993. Non-traditional exports, although still comprising only a small fraction of total exports, showed a significant increase. Import growth also decelerated from about 11 per cent in 1992 to around 1 per cent in 1993 and was estimated to have remained sluggish in 1994 with only a 3 per cent growth. Imports fell for several reasons. Among them were the lower GDP growth; the suspension of the transportation (yellow cab) scheme under which small cars were being imported in bulk and distributed as taxis in urban areas; and the drop in the import prices of crude oil, fertilizers and wheat.

In 1994, exports from Sri Lanka were estimated to have grown by about 14 per cent, the same as in 1993. Textiles and garments still remained the major export products. However, the share of textiles and garments in total exports was steadily decreasing and was being substituted by other manufactured products. The importance of the traditional plantation sector was also decreasing rapidly. Over the last four years there has been a steady increase in the exports of minor agricultural crops (tobacco, cinnamon etc.) and fish. The country's export diversification has been facilitated by measures to permit greater involvement of the private sector in production and export activities. Imports were estimated to increase by about 11 per cent in 1994, slightly higher than 1993. Expenditure on imported consumer items had stabilized over the past three years at around 20 per cent of the total, thus markedly shifting expenditure on imports to intermediate and investment goods.

THE INVISIBLES AND THE PAYMENT BALANCES

The least developed and Pacific island economies

Complete and up-to-date balance-of-payment data for most of the least developed and Pacific island economies are not available. It is generally known, however, that the serious trade and payment deficit is one critical area of weakness in all these economies. Recent efforts at reforms and restructuring of these economies with the objectives, *inter alia*, of narrowing balance-of-payment deficits have not, in most cases, produced the desired results. Improvement in payment balances in some cases has come through a curtailment of imports rather than the stimulation of exports.

The import squeeze reflects the difficulty in financing the deficit which has continued to depend on official development assistance, the volume of which has either stagnated or fallen in recent years in most cases. Despite reforms and liberal incentives provided for foreign investment, the least developed countries have not succeeded so far in attracting a sufficient volume of private capital either. Increasing flows of private transfers, mainly remittances by citizens working abroad, and in a number of cases tourism receipts, have helped to narrow the deficits incurred in merchandise trade. That, along with some increase in inflows of private capital, has made the overall payment balances improve and reserve levels, which were running critically low in 1990-1991, to rise in some cases (see table III.2).

In Bangladesh, the trade deficit increased marginally in 1993. An increase in private transfers largely from remittances of Bangladeshi workers living abroad was offset by a similar rise in net payments on account of services and incomes. The combined balance on these accounts as a result recorded a small deterioration. Official transfers have fully financed the deficit, and a still small but increasing volume of foreign direct and portfolio investments as well as other capital flows since 1991 have helped to build up reserves over this period.

In Nepal and Bhutan, the balance on goods, services and private transfers slipped further into deficit in 1993. This was largely due to a decline in earnings on account of tourism and workers' remittances. Positive balances on services and private

Table III.2. Balance of payments: principal components, 1990-1994

(Millions of US dollars)

		Trade balance	Services and income balance	Private transfers	Balance on goods, services and Private transfers	Official transfers	Investment: Direct	Investment: Portfolio	Investment: Other capital[a]	Foreign exchange reserves[b]
Bangladesh	1990	−1 587.0	−424.5	828.3	−1 183.2	785.8	3.2	0.3	694.3	602.9
	1991	−1 385.8	−361.2	901.8	−845.2	909.8	1.4	2.2	464.0	1 206.9
	1992	−1 255.9	−371.3	1 019.8	607.4	788.2	3.7	8.7	526.0	1 783.2
	1993	−1 283.0	−465.2	1 132.4	615.8	812.9	14.0	8.4	465.8	2 387.9
China	1990	9 165	2 558	222	11 945	52	2 657	−241	839	28 594.0
	1991	8 743	3 698	444	12 885	387	3 453	235	4 344	42 664.0
	1992	5 183	63	804	6 050	351	7 156	−57	−7 349	19 443.0
	1993	−10 654	−2 127	883	−11 898	289	23 115	3 049	−2 690	21 199.0
Fiji	1990	−175.0	146.6	−22.2	−50.6	16.7	75.5	–	−26.9	227.2
	1991	−122.1	138.6	−24.6	−8.1	30.0	19.4	–	−17.0	248.5
	1992	−122.4	144.6	−16.3	5.9	25.9	48.6	–	−11.8	294.3
	1993	−231.0	201.9	−11.1	−40.2	27.1	23.1	–	−37.0	247.2
India[c]	1990	−9 438	−2 764	2 061	−10 141	461	165	..	8 237	2 236
	1991	−2 124	−3 122	2 685	−2 561	426	148	..	5 562	5 631
	1992	−4 092	−3 245	3 378	−3 959	356	344	242	3 746	6 434
	1993	−1 285	−3 189	3 789	−685	370	600	4 115	4 240	15 000
	1994	−2 150	−3 191	2 900	−2 441	300	750	4 250	1 646	19 500
Indonesia	1990	5 352	−8 758	166	−3 240	252	1 093	−93	3 495	7 353
	1991	4 801	−9 323	130	−4 392	132	1 482	−12	4 227	9 151
	1992	7 022	−10 373	229	−3 122	342	1 777	−88	4 440	10 181
	1993	8 231	−10 875	346	−2 298	282	2 004	−201	3 878	10 988
Iran (Islamic Republic of)	1990	975	−3 148	2 500	327	–	–	–	295	–
	1991	−6 529	−4 919	2 000	−9 448	–	–	–	6 033	–
	1992	−3 406	−5 094	1 996	−6 504	–	–	–	4 703	–
Malaysia	1990	2 622	−3 595	3	−970	51	2 332	−255	−292	9 327
	1991	527	−4 747	29	−4 191	8	3 998	170	1 468	10 421
	1992	3 375	−5 086	65	−1 646	−3	4 469	−1 108	4 739	16 784
	1993	3 409	−5 585	76	−2 100	−3	4 351	−984	6 046	26 814
Maldives	1990	−63.1	67.9	−7.4	−2.6	11.2	5.6	–	1.7	24.4
	1991	−82.6	68.1	−16.6	−31.1	22.1	6.5	–	−1.1	23.4
	1992	−116.8	101.7	−18.9	−34.0	14.3	6.6	–	18.9	27.0
	1993	−139.3	103.4	−20.0	−55.9	8.3	6.9	–	18.0	24.9
Nepal	1990	−448.7	51.0	60.4	−337.3	48.2	–	–	304.5	287.0
	1991	−482.4	66.7	53.7	−362.0	57.5	–	–	457.1	388.7
	1992	−375.8	65.5	45.7	−264.6	83.2	–	–	335.9	459.4
	1993	−461.6	86.6	74.3	−300.7	78.2	–	–	283.5	632.3
Pakistan	1990	−2 714	−1 719	2 276	−2 157	504	242	87	843	295
	1991	−2 261	−1 962	2 344	−1 879	483	261	92	538	519
	1992	−2 791	−2 524	3 068	−2 247	377	346	370	1 840	850
	1993	−2 552	−2 660	1 942	−3 270	334	348	292	2 309	1 196

(Continued on next page)

Table III.2 *(continued)*

(Millions of US dollars)

		Trade balance	Services and income balance	Private transfers	Balance on goods, services and Private transfers	Official transfers	Investment: Direct	Investment: Portfolio	Investment: Other capital[a]	Foreign exchange reserves[b]
Philippines	1990	–4 020	611	357	–3 052	357	530	–50	1 577	868
	1991	–3 211	1 350	473	–1 388	354	544	110	2 273	3 186
	1992	–4 695	2 879	473	–1 343	344	228	40	2 940	4 283
	1993	–6 222	2 234	398	–3 590	301	763	–164	2 687	4 546
Republic of Korea	1990	–2 004	–443	266	–2 181	9	–105	811	2 263	14 459
	1991	–6 980	–1 593	20	–8 553	–173	–241	3 116	3 950	13 306
	1992	–2 146	–2 615	257	–4 504	–25	–497	5 742	1 909	16 640
	1993	1 860	–1 967	633	526	–142	–540	10 725	–6 845	20 804
Samoa	1990	–61.15	16.01	39.72	–5.42	12.68	–	–	9.40	64.82
	1991	–71.14	0.92	31.00	–39.22	10.57	–	–	18.60	64.06
	1992	–84.08	–3.17	34.75	–52.50	–	–	–	19.95	57.65
	1993	–80.94	–2.53	28.38	–55.09	16.42	–	–	15.55	47.11
Singapore	1990	–4 717	7 256	–274	2 265	–169	4 004	–1 140	1 794	27 535
	1991	–3 792	8 282	–340	4 150	–159	4 444	–802	–2 708	33 931
	1992	–5 782	10 126	–405	3 939	–190	5 982	–819	397	39 661
	1993	–8 066	10 801	–482	2 253	–215	6 062	–944	4 335	48 066
Solomon Islands	1990	–7.24	–58.60	4.67	–61.17	33.26	10.44	–	12.42	16.49
	1991	–8.55	–65.68	1.88	–72.35	36.25	14.51	–	0.59	7.67
	1992	14.31	–51.91	1.78	–35.82	33.95	14.17	–	8.26	22.70
Sri Lanka	1990	–472.6	–366.8	362.4	–477.0	178.1	42.5	–	435.6	422.0
	1991	–804.4	–394.5	401.3	–797.6	202.4	43.8	32.1	613.2	685.0
	1992	–715.1	–379.9	461.7	–633.3	182.6	121.0	25.7	354.6	899.0
	1993	–742.1	–358.5	559.8	–540.8	160.2	187.6	67.2	669.6	1 601.0
Thailand	1990	–6 750	–744	26	–7 468	187	2 303	–38	6 833	13 247
	1991	–5 990	–1 844	163	–7 671	98	1 847	–81	9 993	17 287
	1992	–4 161	–2 571	323	–6 409	54	1 969	927	6 900	20 012
	1993	–4 146	–3 093	281	–6 958	32	1 493	5 455	7 491	24 078
Tonga	1990	–40.45	11.90	30.57	2.02	10.47	0.10	–13.61	–0.04	30.04
	1991	–40.86	1.55	30.23	–9.08	7.07	0.20	–3.73	5.45	30.17
	1992	–36.44	–2.57	27.96	–11.05	9.64	1.24	–0.45	5.42	29.82
	1993	–37.60	–0.11	34.93	–2.78	6.87	0.35	–0.10	3.02	34.82
Vanuatu	1990	–65.61	34.91	11.12	–19.58	29.86	13.11	–	0.68	34.69
	1991	–59.15	14.84	17.69	–26.62	32.05	25.47	–	–53.27	36.69
	1992	–48.99	12.65	7.01	–29.33	32.89	26.45	–	–2.79	38.71
	1993	–47.28	3.80	10.76	–32.72	32.04	25.97	–	–5.77	45.47

Source: International Monetary Fund, *International Financial Statistics*, vol. XLVIII, No.1 (January 1995).

[a] Comprised of resident official, deposit money bank and other sectors not elswhere specified. [b] End of period. [c] Fiscal year.

transfers have usually helped to narrow deficits Nepal incurred on merchandise. Official transfers have met remaining deficits but in recent periods a rise in private capital inflows has been noticeable.

A decline in exports and an increase in imports led to a deterioration of Cambodia's trade balance. In 1993, official transfers in the form of foreign aid were by far the most important source of capital inflow into the country, rising by more than 17 times the level recorded in 1992. The substantial increase in foreign aid was in response to the appeal of the Secretary-General of the United Nations to the international community to support Cambodia's rehabilitation efforts. The country has also been able to attract some FDI flows mainly in the tourist industry.

In Maldives, the deficit on merchandise trade has been widening since 1990. The services income, mainly representing receipts from the tourist industry, increased considerably in 1992 and 1993, leaving a relatively small deficit in the combined goods, services and private transfers account. Nevertheless, the combined deficit on goods, services and private transfers has been rising since 1990. In the past, the deficit was largely financed by grants from abroad, but these had declined sharply in 1993.

In Myanmar, the deficit on the balance of trade remained high but was mostly covered by income derived from tourism and other services. Official transfers from foreign donors, and short- and long-term borrowing from abroad financed the remaining deficits. In recent years, there has been an increase in FDI inflows, particularly in hotel building and other tourism-related activities, as well as in the production of tobacco and beverages.

Both Samoa and Vanuatu have been able to offset partially their merchandise trade deficits through income from services (mainly from the tourist industry) and from other private transfers made by citizens living abroad. Official transfers remained the most important form of capital inflows to these countries. Solomon Islands appeared to be enjoying a trade surplus but they experienced a larger outflow on services and income. This could be the result of profit remittances and interest payments by logging companies. In 1993, the country had also experienced a relatively large outflow of capital because of substantial loan repayments by logging companies.

Unlike the other least developed countries, Kiribati and Tuvalu experienced a surplus in their transactions on goods, services and private transfers in 1993. A large trade deficit in Kiribati was more than offset by increased earning from services and interest on the Revenue Equalization Reserve Fund, which was established from the proceeds of phosphate royalties. In Tuvalu, inflows in the form of remittances from Tuvalu citizens working abroad, interest earnings from investments of the Tuvalu Trust Fund which was established in 1987 from the aid contribution of donor countries, and official aid received by the country more than covered the country's trade deficit.

Among the other Pacific island economies, Fiji's merchandise trade deficit deteriorated sharply in 1993. Even though there was an improvement on the services and income balance with an increased surplus arising mainly from higher tourism receipts, this was not sufficient to offset the trade deficit. Official transfers increased marginally but FDI flow fell to less than half of the previous year.

In Papua New Guinea, the combination of robust export growth and a decrease in merchandise imports produced a substantial surplus in the trade balance in 1993. The lower level of imports was mainly caused by reduced imports by the mining and petroleum sectors. This subsequently translated into a surplus on the balance on goods, services and private transfers. However, there was a substantial increase in private capital outflows during the year.

Tonga has had deficits on its balance of trade for several years. An increase in imports in 1993, mainly attributable to major building projects and the importation of electric generating equipment, caused the balance to further deteriorate. The trade deficit was offset by a substantial amount of transfers comprising mainly gifts from Tongans overseas and church donations as well as ODA.

Other developing economies

In 1993, China faced a deficit of over $10 billion on its merchandise trade. This was the result of growth in imports at a rate over three times higher than the rate of growth in exports. The rapid pace of domestic economic activities and the liberalization of policy kept imports rising rapidly in 1992 and 1993. The trade balance was, however, returning to a balance or a small surplus in 1994 as exports grew faster than imports during the year, despite continued pursuit of import liberalization measures. This development was attributed largely to the devaluation of the yuan renminbi which helped exports and discouraged imports. The country's earnings from tourism were estimated to have doubled to $7.0 billion in 1994. The balance on services and income turned negative in 1993 as interest and dividend payments on stocks of foreign loans and investments rose. The continued strong inflow of capital, particularly FDI, however, was more than adequate to offset the deficit, enabling a net addition to reserves.

In 1993, the Republic of Korea recorded a surplus on its trade balance after three consecutive years in deficit. That enabled a small surplus to appear in the balance on goods, services and transfers. However, this reversal was short-lived as in the first half of 1994, the balance was once more in deficit and was likely to have worsened by the end of the year. This was caused largely by imports of capital goods and raw materials to supply the strong production boom. In addition, the balance of payments of the country was weakened by a reduction in tourism revenue and investment income.

Indonesia's merchandise exports usually exceeded merchandise imports resulting in trade surpluses. However, a relatively bigger deficit on the services and income account showed up in a deficit on the balance on goods, services and private transfers. In 1993, the deficit in the services and income account increased which was partially offset by a rise in private transfers. With a larger trade surplus, the combined deficits on these three accounts was much lower during the year. On the capital account, FDI flows registered a strong increase, although private flows through the banking system slowed. The overall result enabled a net addition to reserves.

The merchandise trade surplus of Malaysia was higher in 1993 compared with 1992. However, a bigger deficit on the services and income account produced a higher deficit on the balance on goods, services and private transfers. Capital inflows in the form of FDI and through banking channels kept the overall payment balances in surplus and increased the country's reserves by a large margin.

The Philippines' deficits on merchandise trade in 1993 was larger by a third over the level of 1992. Overseas workers' remittances and receipts from tourism have increased dramatically since 1990. Net receipts, however, fell in 1993 from a peak of $2.9 billion in 1992. The combined trade, services and private transfers recorded a deficit two-thirds larger than in 1992. However, there has been a steep upsurge in capital inflows which more than offset the deficit in current transaction and added to reserves, which kept rising steadily from the critical level reached in 1990.

Singapore usually recorded a large trade deficit. However, a bigger surplus on the services and income account kept the balance on goods, services and transfers in surplus. The surplus on these accounts was reduced in 1993 but FDI and other capital inflows kept the country's foreign exchange reserves rising.

Thailand's merchandise trade deficit has been falling since 1990. However, the country has been facing a rising net outflow on services and income reflecting payments attributable to large foreign investment in the country, and increased expenditures by Thai travellers abroad. Added to the lower net inflow of private transfers, the deficits on these combined accounts remained high in 1993. A large net inflow of capital resulted in a surplus on the overall balance of payments, which added to the country's foreign exchange reserves. Although FDI inflow was lower in 1993, the booming capital market continued to cause a large influx of portfolio and banking capital.

In the case of Viet Nam, a large trade deficit had developed in 1993 in contrast to a nearly balanced trade account in 1992. A higher deficit on the balance on goods, services and private transfers was estimated for 1994. Resumption of aid from multilateral agencies and a greater inflow of FDI have considerably eased pressure on the overall balance of payments.

In South Asia, India has come a long way in reducing its external trade deficit from nearly $10 billion in 1990, which had triggered an economic crisis in the country. In 1993, the robust growth in exports along with subdued growth of imports resulted in the smallest merchandise trade deficit since 1990. The net deficit on services and income remained more or less stable while private transfers from workers and non-resident Indians rose significantly. While the combined result on these accounts was close to a balance, India also experienced an upsurge in capital inflows, mainly direct and portfolio investments. The trend was continuing in 1994 although the deficit on the current account transactions, particularly on merchandise trade, was rising somewhat as imports picked up. India's foreign exchange reserves tripled from 1992 to rise to almost $20 billion in 1994.

During 1993, exports of services from the Islamic Republic of Iran showed a substantial increase. Together with the decrease in imports, the deficit on the balance on goods, services and private transfers improved. Debt obligations for financing post-war reconstruction programmes increased steeply in the early 1990s and presented an extraordinary payments problem in 1991-1992. In 1993, in an effort to manage external deficit, various demand management policies including exchange rate depreciation and bilateral refinancing arrangements were used.

In Pakistan the deficit on the balance on goods, services and private transfers worsened in 1993. Although the deficit on merchandise trade was lower due to sluggish imports, a large drop in private transfers or remittances from Pakistanis working abroad mainly accounted for the worsening deficit. Official transfers or foreign grants to Pakistan have been falling and reached their lowest ever level in 1993. Foreign direct and portfolio investments have shown a moderate rise reflecting the liberal policy the country has been pursuing. Other forms of capital inflow, mostly private and public borrowings and banking flows have risen sharply in 1992-1993. These inflows have helped to build up the level of foreign exchange reserves that had reached critical levels in 1990. In 1994, the overall balance-of-payments situation and foreign exchange reserves were to improve further, as inflows to foreign currency accounts held by citizens and inflows of short- and long-term capital including FDI, were rising.

Sri Lanka's deficit on current account transactions moderated somewhat in 1993, mainly owing to a higher level of private transfers or remittances from abroad. Official transfers to Sri Lanka have been falling but still remained significant in relation to the absolute size of the deficit on current transactions. Private capital flows have risen steeply since 1991 and, as in other cases in South Asia, have helped build up reserves that ran low in 1990. Reserves quadrupled in 1993 over their 1990 level.

IV. REFORM AND LIBERALIZATION OF THE FINANCIAL SECTOR

During the last decade considerable emphasis was put on the need for financial sector reform in developing countries, with much discussion on the relative merits of specific reforms and on the speed and phasing of their implementation.[1] Practically all countries in the Asian and Pacific region have been undertaking such reforms, albeit at different speeds and with varying focuses, and this process is likely to continue. The emphasis has therefore shifted from whether reforms should be undertaken towards the limits of these reforms in the light of their impact on the real economy, in particular their effects on domestic savings and investment. Another concern has been to develop ways and means of effectively handling the consequences of the increased exposure of exchange rates, foreign exchange reserves and domestic price levels to instability arising from the movements of highly mobile speculative funds in and between countries within a liberalized and increasingly globalized financial system.[2] The tools available to Governments to influence or control financial flows, domestic money supply and rates of inflation are changing as a result of developments in the financial markets. In addition, there is an increasing need for effective prudential regulation of the sector by Governments. All these elements place increasing demands on the capabilities of national officials responsible for policy in the financial area and on domestic and international supervisory and monitoring institutions.

This chapter is designed to trace through these rapidly changing circumstances. Following a brief description of the role of the financial sector in an economy, there is a discussion of why Governments intervened heavily in the financial sector in the past and of the major causes of recent moves towards liberalization. This is followed by an illustrative overview of the reforms which have been undertaken to date and an assessment of the impacts of these reforms on various economic indicators. The chapter concludes with a discussion of the major implications of reforms and the new policy issues facing countries in the region.

ROLE OF THE FINANCIAL SECTOR IN AN ECONOMY

There are three major functions of the financial sector in an economy. The first and most basic function is to facilitate transactions among individuals and enterprises by providing convenient methods of payment, such as cheques and bank transfers. Increasing the efficiency of the methods used has a direct, positive impact on the efficiency of the real economy in that transactions are completed more quickly, with greater confidence and at smaller cost. The second function is to provide a mechanism for mobilizing savings from surplus sectors in the economy and to use these for investment by deficit sectors. The financial sector thus serves the role of intermediator between savers and investors and allocator of investment finance; its efficiency in so doing again affects the functioning of the real economy. The third role is to provide a means of selecting the types of credit, their maturity etc. for individuals and enterprises on the basis of credit and risk assessments. This allows access to credit to be based on an assessment of the relative economic viability of investment propositions, for the generation of considerable information on the enterprise sector and for a transparent means of comparing the performance of enterprises. For investors, this implies a wider choice of modes of savings with various yield, liquidity and risk profiles.

The degree to which the financial sector in a country actually performs these functions is directly related to its level of development. Usually

1 For further discussion, see World Bank, *World Development Report 1989* (Washington, DC, Oxford University Press, June 1989) and references therein.

2 See Yilmaz Akyuz, "Financial liberalization: the key issues", United Nations Conference on Trade and Development Discussion Paper No. 56 (Geneva, March 1993).

the transaction function is developed first, with the other functions being developed and becoming progressively more sophisticated and complex as economic development progresses. Figure IV.1 provides a simplified picture of the flow of funds through the financial sector in a fairly developed economy. The degree of performance is often measured by the ratio of the turnover in the financial sector to the value of GDP. This ratio essentially measures the degree of monetization. If this ratio is small and not growing then there is said to be financial shallowness. Financial deepening refers to the growth in this ratio and is connected to the proposition that in a growing economy the financial sector should be expanding faster than the real economy. The implicit assumption is that the degree of monetization is directly and positively related to the efficiency with which activities are carried out in the real sector of an economy.[3] Another concept which is useful in assessing the performance of the financial sector is financial broadening, which refers to the increase in the number and types of financial institutions and instruments in a country. In such assessments, the term financial repression is used to refer to government intervention in the financial sector, which restrains the process of financial deepening and broadening through controlling interest rates or limiting the number and types of financial institutions, for example.

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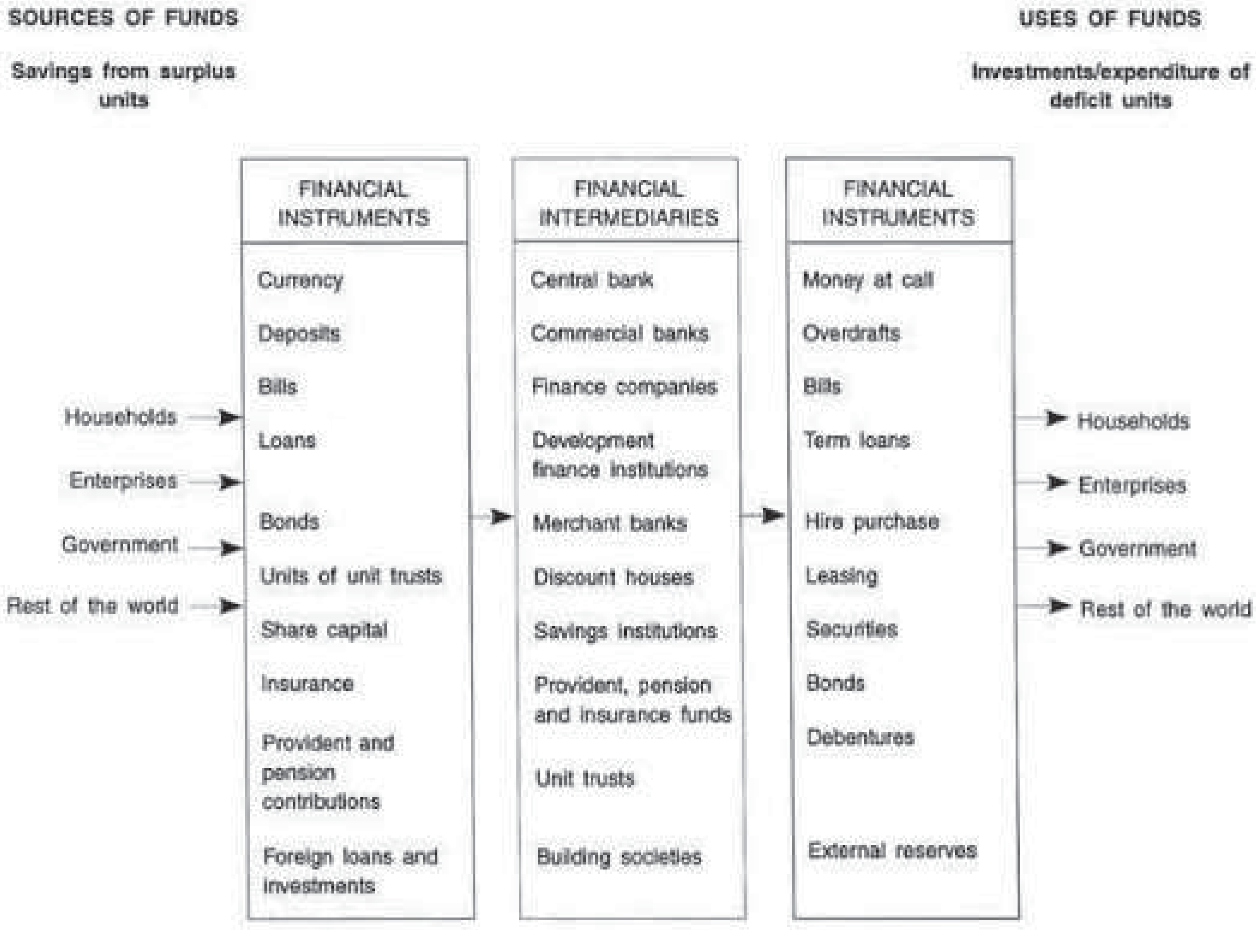
[3] R. I. McKinnon, *Money and Capital in Economic Development* (Washington, DC, The Brookings Institution, 1973) and E. S. Shaw, *Financial Deepening in Economic Development* (New York, Oxford University Press, 1973).

Figure IV.1. The flow of funds in an economy with a relatively developed financial system



Sources: Bank Negara Malaysia, *Money and Banking in Malaysia* (Kuala Lumpur, 1989), p. 64.

Commercial banks, as the facilitators of transaction payments and as deposit takers from the surplus sectors of the economy and lenders to the deficit sectors, headed by a supervisory central bank, have traditionally been the core of the institutional infrastructure of the financial sector in Asia.[4] In Thailand, for example, commercial banks accounted for over 80 per cent of the total assets of all financial institutions, savings mobilized and credit extended and these ratios have been quite stable over time.[5] Similarly, in Indonesia, the banks held over 90 per cent of the gross assets of the financial system in 1991.[6] Public sector ownership of these banks has been fairly common in the region. For example, all the major banks in Bangladesh, India, Indonesia, Nepal, Pakistan and the Republic of Korea were under public ownership until quite recently and several continue to be in the public sector.

The banking industry in individual countries in the region is generally characterized by an oligopolistic structure as a result of restricted entry as well as limitations on foreign ownership of domestic financial institutions. The bank concentration ratio, defined as the share of the four largest banks in the total assets of the banking system, was as high as 60 to 65 per cent in 1987 in Indonesia, Malaysia, Taiwan Province of China and Thailand.[7] In Bangladesh four nationalized commercial banks recently held similar proportions of banking assets and liabilities, despite the presence of 13 other banks in the country.[8] In the case of Pakistan, the bank concentration ratio for the five largest banks was 84 per cent in 1991. In the late 1980s, two banks in Nepal accounted for more than 90 per cent of bank deposits, and two state-owned banks in Sri Lanka accounted for about 70 per cent of commercial bank assets.[9]

REASONS FOR AND MODALITIES OF GOVERNMENT INTERVENTION

Governments set economic and social goals to be fulfilled simultaneously. The financial sector, with its set of institutional and policy tools, has often been used by Governments to promote social objectives centring around the questions of income distribution and uneven access to payment and credit systems. For example, in many countries banks were developed in the public sector or private commercial ones were nationalized. Governments designed and directed credit programmes, controlled interest rates, restricted the access of its citizens to foreign currencies, and of foreigners to its financial sector institutions, and maintained a fixed exchange rate for its currency. The motivations behind these actions were several and often varied with the stage of development of the economies.

Most economies of the region were traditionally rural-agricultural with small modern urban sectors. The existing or emerging banking and financial institutions in the private sector catered mostly for the needs of the urban sector. The financial needs of the rural-agricultural sector and of the poorer unorganized urban sectors remained unmet, except through their own resources or through the informal financial sector offering services at high costs. Thus, Governments were concerned to spread access to credit, payment and saving facilities through banks beyond the modern urban sector, to encourage a monetization of transactions in the economy and to encourage a more even spread of development. To do this they promoted public sector rural financial institutions and established branches of government-owned banks in areas where banking services did not exist.

The scope of financial services remained limited even in the modern sector. The commercial banking services were traditionally limited to meeting

[4] For descriptions of the structures of the financial sectors in Asia in the early 1980s, see S.Y. Lee and Y.C. Jao, *Financial Structures and Monetary Policies in South-east Asia* (London, Macmillan Press, 1982).

[5] S. Kirakul, J. Jantarangs and P. Chantanahom, "Economic development and the role of financial deepening in Thailand", *Papers on Policy Analysis and Assessment* (Bangkok, Economic Research Department, Bank of Thailand, 1993) p. 45.

[6] Anwar Nasution, "An evaluation of the banking sector reforms in Indonesia, 1983-1993", *Asia-Pacific Development Journal*, vol. 1, No. 1 (June 1994), p. 64.

[7] B. Fischer and H. Reisen, *Liberalizing Capital Flows in Developing Countries: Pitfalls Prerequisites and Perspectives* (Organisation for Economic Co-operation and Development, 1993), p. 119.

[8] ESCAP, *The Financial Sector of Bangladesh: Its Role and Performance vis-à-vis Some Other Experiences in the ESCAP Region* (ST/ESCAP/1350), p. 45.

[9] W. Tseng and R. Corker, "Financial liberalization, money demand, and monetary policy in Asian countries", International Monetary Fund Occasional Paper No. 84 (Washington, DC, July 1991), pp. 39-41.

the needs for short-term finance. Merchant or investment banking, known for its specialized services of providing long-term finance to industrial investors and producers, was mostly absent. The desire to redress this imbalance in the provision of financial services led to the setting-up of specialized financial institutions and, in some cases, the nationalization of commercial banks.

Governments tried to assure access to credit for the specific economic sectors they sought to promote as part of their development plans, often irrespective of the credit and risk assessment of the sector or enterprise receiving such credits. They established directed credit programmes for certain sectors, with a plethora of such programmes frequently existing simultaneously in any one country. Often government-owned enterprises or parastatals were major beneficiaries of these programmes.[10] In the case of industry the objective was to provide cheaper long-term finance to priority industries. Agriculture was targeted to raise output and speed up the introduction of new technologies. Small enterprises received cheaper credit for employment generation. Exporters were provided credit to promote exports and to compensate them for industrial and trade policies that were biased against them.

Governments also tried to assure access to credit at "reasonable" rates. Therefore, either they controlled interest rates across the board or they controlled or subsidized only those for directed credit programmes. Most developing countries in the region had highly regulated regimes of interest rates for both deposits and lendings. In many countries, the nominal rates were set at low levels, barely covering annual inflation rates. This resulted in very low or even negative real rates (see table IV.1) and had the unintended effect of discouraging savings in domestic financial institutions, encouraging the outflow of savings and creating a larger demand for credit than warranted on the basis of assessments of economic viability.

Governments often viewed the financial sector as an adjunct to their monetary and fiscal policies. For example, beyond the interbank call market, the only significant money market instrument that used to exist in most countries was short-term treasury bills issued by Governments to finance their own deficits. In the absence of an active market for them, the banks were often obliged to hold these bills as part of their statutory reserve requirements, or as preconditions for obtaining permission to undertake certain activities such as opening new branches.

In most countries of the region, the primary form of credit was loans from banking institutions. As a result of the policies outlined above, there was relatively easy availability of inexpensive loan finance from banks and specialized finance institutions for select clients. Besides, Governments had relatively easy access to loans from international financial institutions for their major development projects. As a result, the development of stock markets and other financial markets remained weak. Another factor which contributed to this situation was that both public and private sector companies were often reluctant to issue equities for fear of dilution of their ownership and control and because of stringent information disclosure requirements that companies listed on the stock exchange usually have to meet. In addition, the functioning of a stock market requires a more transparent and developed legal and regulatory framework than does a loan-based system.

Governments used foreign exchange policies as a tool for the trade sector. They often maintained a fixed exchange rate, thus eliminating the role of a foreign exchange market. They kept tight control on access to foreign exchange, with receipts being deposited with the central bank and payments needing authorization from the bank. This necessitated limits or a ban on the involvement of foreign banks in their financial sector.

Thus the reasoning behind heavy government involvement in the financial sector was connected to the emphasis on planned development and the active involvement of the Government in owning and executing development programmes.

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[10] Countries which operated directed credit schemes included those experiencing fast (e.g. Malaysia, the Republic of Korea and Thailand) as well as slow (e.g. India, Pakistan and the Philippines) rates of growth. Such schemes were usually quite complicated with their own interest rates, maturity and eligibility criteria. In Malaysia, directed credits accounted for about 30 per cent of bank portfolios in the late 1980s. The Republic of Korea had 221 formal directed credit programmes. The Philippines had 49 schemes for agriculture and 12 for industry. In Pakistan, 70 per cent of new lending by the large, nationalized banks was provided to target sectors (World Bank, *World Development Report 1989* (Washington, DC, Oxford University Press, June 1989), p. 55). Priority lending in India absorbed about 40 per cent of the deposits (R.J. Cheliah, "Financial and fiscal sector reforms in Asian countries", *Asian Development Review*, vol. II, No. 2, 1993, p. 49).

Table IV.1. Annual bank deposit and lending rates in selected countries of the ESCAP region

(Percentage)

		1980	1985	1990	1991	1992	1993
Bangladesh							
Deposit rate	– nominal	11.1	14.0	13.3 [a]	12.3	8.5	..
	– real	–2.3	3.3	5.2	5.0	4.2	..
Lending rate	– nominal	..	..	18.0	18.0	16.0	..
	– real	..	..	9.9	10.8	11.7	..
Lending rate – deposit rate		..	..	4.8	5.8	7.5	..
Fiji							
Deposit rate	– nominal	4.5 [b]	6.0 [b]	4.0 [a]	4.1 [b]	4.1 [b]	3.7
	– real	–10.1	1.5	–4.2	–2.4	–0.8	–1.5
Lending rate	– nominal	12.0	13.5	11.9	12.3	12.4	11.7
	– real	–2.6	9.0	3.6	5.8	7.5	6.5
Lending rate – deposit rate		7.5	7.5	7.9	8.2	8.3	8.1
India							
Deposit rate	– nominal	7.0	8.5	9.0	9.0	13.0	11.0
	– real	–4.5	3.0	0.1	–4.9	1.2	4.6
Lending rate	– nominal	16.5	16.5	16.5	17.9	18.9	16.3
	– real	5.0	11.0	7.6	4.0	7.2	9.9
Lending rate – deposit rate		9.5	8.0	7.5	8.9	5.9	5.3
Indonesia							
Deposit rate	– nominal	9.0	18.7	18.5	22.8 [b]	18.9	16.3
	– real	–9.0	14.0	6.0	13.4	11.4	6.6
Lending rate	– nominal	..	21.5 [c]	20.6	..	24.0	20.2
	– real	..	16.8	8.1	..	16.5	10.5
Lending rate – deposit rate		..	2.8	2.1	..	5.1	..
Malaysia							
Deposit rate	– nominal	7.4	9.3	6.6	7.4	8.0	7.2
	– real	0.7	8.9	3.9	3.0	3.3	3.9
Lending rate	– nominal	7.8	11.5	7.2	8.1	9.5	8.5
	– real	1.0	11.2	4.5	3.7	4.8	5.1
Lending rate – deposit rate		0.3	2.3	0.6	0.7	1.5	1.3
Pakistan							
Deposit rate	– nominal	10.2	9.3	11.6	10.8	10.9 [d]	11.5 [d]
	– real	–1.8	3.6	2.6	–1.0	1.4	2.2
Lending rate	– nominal	..	..	..	..	..	..
	– real	..	..	..	..	..	..
Lending rate – deposit rate		..	..	..	..	..	..
Papua New Guinea							
Deposit rate	– nominal	7.5	10.2	10.6	10.9	6.9	..
	– real	–4.5	6.4	3.6	3.9	2.6	..
Lending rate	– nominal	11.2	11.5	15.5	14.2	14.5	11.3
	– real	–0.9	7.8	8.6	7.2	10.2	6.4
Lending rate – deposit rate		3.7	1.4	5.0	3.3	7.7	..
Philippines							
Deposit rate	– nominal	14.0	19.8	17.3	15.4	12.8	10.1
	– real	–3.9	–3.3	3.1	–3.3	3.9	2.5
Lending rate	– nominal	14.0	28.6	24.1	23.1	19.5	14.7
	– real	–3.9	5.5	10.0	4.4	10.5	7.1
Lending rate – deposit rate		0.0	8.8	6.8	7.7	6.7	4.6

(Continued on next page)

Table IV.1 *(continued)*

(Percentage)

		1980	*1985*	*1990*	*1991*	*1992*	*1993*
Republic of Korea							
Deposit rate[e]	– nominal	22.9	10.0	10.0	10.0	10.0	8.5
	– real	–5.8	7.5	1.4	0.7	3.8	3.7
Lending rate	– nominal	18.0	10.0	10.0	10.0	10.0	8.6
	– real	–10.7	7.5	1.4	0.7	3.8	3.8
Lending rate – deposit rate		–4.9	0.0	0.0	0.0	0.0	0.1
Singapore							
Deposit rate	– nominal	9.0	5.6	5.5	5.1	3.3	2.8
	– real	0.6	5.1	2.1	1.7	1.0	0.5
Lending rate	– nominal	11.7	7.9	7.4	7.6	6.0	5.4
	– real	3.3	7.5	3.9	4.2	3.6	3.0
Lending rate – deposit rate		2.7	2.4	1.9	2.5	2.6	2.6
Sri Lanka							
Deposit rate	– nominal	20.0	15.0	16.0	15.0	16.8	16.2
	– real	–6.1	13.5	–5.5	2.8	5.4	4.5
Lending rate	– nominal	..	14.8	18.6	19.6	19.9	20.4
	– real	..	13.3	–2.9	7.4	8.5	8.7
Lending rate – deposit rate		..	–0.2	2.6	4.6	3.1	4.2
Thailand							
Deposit rate	– nominal	12.0	13.0	13.8	10.5	8.5	7.0
	– real	–7.9	10.5	7.8	4.8	4.3	3.5
Lending rate	– nominal	18.0	19.0	15.0	..	..	..
	– real	–1.9	16.5	9.1	..	..	..
Lending rate – deposit rate		6.0	6.0	1.3	..	..	..

Sources: ESCAP, based on International Monetary Fund, *International Financial Statistics*, vol. XLVII, No. 9 (Washington, DC, September 1994), tape no. 94037F; Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries 1994*, vol. XXV (Manila, Oxford University Press, July 1994); and national sources.

Note: Nominal deposit rate indicates interest rate on time deposits of 12 months. Lending rate indicates the rate for short- and medium-term borrowing by the private sector.

[a] 1989. [b] Saving deposit rate. [c] 1986. [d] Average profit rates of the two largest banks of Pakistan: Habib Bank Limited and National Bank of Pakistan. [e] Time deposit of over 12 months.

MOTIVATION FOR LIBERALIZATION

The major common characteristics of the financial sector that thus emerged in most Asian and Pacific countries and which prevailed up to the early 1980s included restrictions on interest rates, controls on domestic credit, segmented financial markets, underdeveloped money and capital markets, and tight exchange control systems. In this environment of regulatory controls, banking and financial services generally did not flourish. As the economies of the region grew and became more diversified, their financial needs also grew and changed. In general, economic growth requires that the financial sector should grow faster than the real economy, allowing for financial deepening, and there should be some broadening in the range and number of financial institutions and instruments. Under highly regulated regimes, the growth of the financial sector tended to remain repressed, resulting in financial shallowness.

During the 1980s there were very substantial changes in both the real and financial sectors. Domestic markets were thrown open to competition to promote efficiency and to reduce the costs of domestic production, creating a growing need for the mobilization of domestic resources as well as the import of capital and technology. Reform and liberalization of the trade, balance of payments and exchange rate regimes became necessary. The control and regulations, generally protective of various sectors of the domestic economy, were thought to impair incentives, efficiency in domestic production and ability to compete in the international market-place.

While the interventions of the Government in the financial sector may have helped to further some of the development aims, such as improving access of the poorer and rural sectors to payments and savings instruments, these were perceived as imposing significant costs in terms of hampering the efficient functioning of the financial sector and the economy. As the economies grew, there was an urgent need to reduce distortions and improve efficiency in the allocation of scarce financial resources, to improve the range and reduce the cost of financial services through increased competition from within the country and from outside, to mobilize domestic savings and investment, and to attract more external finance in the form of direct and portfolio investments by private foreign investors. Liberalization and reform, therefore, have been perceived as a necessary change of course.

With regard to the structure of financial institutions, nationalization and public sector ownership of banks and other financial institutions tended to inject bureaucratic rigidity into an essential service industry, to the detriment of operational efficiency, the quality of customer services, and the efficient performance of its role of intermediation between savers and users of resources at competitive costs reflecting the real value of the resources to both. Hence the motivation for Governments to privatize and to increase competition in the sector to reduce costs and improve efficiency.

Nationalization or public ownership apart, banks and financial institutions generally came to be closely regulated in respect of the scope of their activities, general asset and liability management, and the pricing of the assets and liabilities. For instance, the freedom of banks in respect of the number and location of branches to be opened and operated was often restricted. They were similarly not free to price their assets and liabilities based on their own judgement and market criteria, balancing profitability with liquidity and the risks involved. Rather, interest rates were administratively set for the acquisition of both liabilities and assets by banks. Moreover, under directed credit programmes instituted in most countries, banks and financial institutions were required to advance stipulated proportions of their credit to designated sectors. This situation seriously compromised their profitability. Loan defaults and bad debts were frequent and often quite extensive. With the plethora of legal and regulatory stipulations, the system was also subject to arbitrary political and administrative intervention. Therefore, there was a need to improve the economic viability of banks and other financial institutions by liberalizing the rules under which they operated and making these institutions more responsible for their own operations.

While initially well-intentioned, directed credit programmes were seen to be administratively difficult and sometimes led to dynamic sectors being deprived of their credit needs, leading to an inefficient allocation of resources. Under such programmes, credit goes to designated sectors, not necessarily those where the rate of return is the highest. In addition, moves in the real economy to privatize government enterprises or to make their functioning more commercially oriented required a more competitive allocation of credit. As concessional credits involve implicit subsidies which are borne by the financial institutions, the solvency of the institutions was at risk. In some instances these subsidies were financed through cheap rediscount from the central bank. In other cases, these had to be covered by cross-subsidization, by charging higher rates to other creditors or by paying lower interest rates to depositors. In many instances directed credits failed to reach the intended beneficiaries. Both borrowers and lenders circumvented rules in order to have credits issued. The larger and more influential borrowers often benefited more from such credits, although the objective was to help the small and the poor. Subsidized credits also tended to encourage rent-seeking behaviour as acquiring subsidized credit could inflate profits without exerting efforts to expand production or improve efficiency. Many directed credits ended up as non-performing loans for the banks as borrowers used them for less productive or even non-viable projects. In some cases, borrowers also willingly defaulted, believing that no action would be taken against them. Therefore, there was a clear need to eliminate or significantly reduce the number of directed credit programmes.

With growth there was also a need to improve the efficiency of the payments and savings system, and increasingly to tap domestic savings for domestic investment. Although the evidence on the impact of the interest rates on savings is not always conclusive,[11] low interest rates that were set arbitrarily were believed to have discouraged savings through financial institutions. Regulated interest rates were also thought to have distorted the allocation of the savings mobilized to a less efficient pattern than competitive markets could have ensured by channelling resources to those who valued them the most. This was seen as a reason behind the accumulation of bad debts in the banking systems of many countries, threatening the very existence of many financial institutions. Often these bad debts were due to loans made to government-owned enterprises at subsidized rates of interest. Freeing interest rates to be determined by market forces was thus seen as necessary not only to stimulate savings in monetized forms, but also to channel them to their most productive use.

Deregulating interest rates was also seen as a way to reduce legal and illegal outflows of domestic capital, especially as access to foreign exchange was made easier. There was a need to make the domestic market attractive to domestic savers.

As the economies grew, so did the need for credit and more sophisticated methods of allocation and risk assessment for financing both the government deficit and enterprise investment. The systems based solely or primarily on loans were seen to be too restrictive and there was an increasing need for developing other forms of capital markets. Until the 1980s, the money and capital markets in the region were relatively undeveloped. Interbank call markets existed in some countries to help banks meet their short-term liquidity requirements. The long-term funding requirement of the industrial and other sectors was met in most cases by loans from banks and development finance institutions. Along with institutional growth, the importance of primary and secondary money and capital markets and their instruments, such as treasury bills, certificates of deposit, commercial papers of various sorts and common stocks, has increased considerably in recent years in many countries. The primary and secondary money markets are useful for central banks to implement monetary policy efficiently in a liberalized system. Bonds and stocks serve as instruments of longer-term finance for corporate and other business sectors including state-owned enterprises. Through capital market instruments, resources can be transferred directly from lenders to borrowers, avoiding the process of intermediation and the associated costs. Capital markets also make long-term investments more liquid and can cater for varying maturity preferences of lenders and borrowers. They facilitate the dispersion of business ownership by opening access to capital ownership by the public at large. Active capital markets can facilitate the successful implementation of privatization plans that countries in the region have launched and, such privatization, in turn, can be a spur to the growth of the markets.

Many countries in the region relied on the trade sector as the engine of growth. This meant that the financial sector needed to be able to respond effectively to the trade sector's need for fast access to short-term credit and to foreign exchange. Foreign exchange decontrol, flexible exchange rates, and removal or easing of restrictions on capital flows were required.

Concomitantly an increasing reliance came to be placed on the international market for finance as the access of many countries in the region to official development finance shrank. Deregulation of banking and finance in major industrial countries helped to establish a global market for finance and also made for easier access to that market for capital and credit for the developing countries. In order to take advantage of this situation, the capital account had to be deregulated and domestic financial institutions, products and instruments, and their prices (interest rates) as well as the rules and regulations governing them had to conform to international standards.

AREAS OF LIBERALIZATION AND IMPACT OF REFORMS

The various elements of reforms that have been introduced and implemented in countries of the region can be grouped into four major areas: reduction of barriers to entry for banks and other financial institutions; deregulation of interest rates and reduction in or elimination of directed credit programmes; promotion of new financial markets; and external financial liberalization. These have been undertaken at various times starting approximately in the early 1980s, at different speeds and in different sequences. It should be noted that hardly any country in the world has gone in for total deregulation of its financial markets. Both developed and developing countries have systems of prudential

[11] For further discussion, see Carlos J. Glower, "Interest rate deregulation: a brief survey of the policy issues and the Asian experience", Asian Development Bank Occasional Papers No. 9 (Manila, July 1994), p. 1.

supervision and regulation as well as some controls. This situation is not only warranted by concern for social goals but also takes into consideration the conduct of monetary policy and balance-of-payments management.

Reduction of barriers to entry in the banking sector

The structural reforms undertaken in the banking sector centred on privatizing state-owned banks, reducing barriers to entry for both domestic and foreign private banks, liberalizing the types of activities they could undertake and improving the prudential regulation of the sector. These reforms were intended to increase competition in the banking sector in the provision of services to customers, to improve the payments system and to encourage savings through the banking system.

Privatization of state-owned banks

The banking sector in a number of countries, including Bangladesh, India, Indonesia, Nepal, Pakstan and the Republic of Korea, was dominated by a limited number of nationalized or government-owned banks. One of the criticisms was that government ownership of banks created scope for political interference in the deployment of bank resources, which sometimes went against prudential commercial principles and adversely affected the viability of the banking system itself. As these banks at times had to extend loans on non-economic considerations, there was an accumulation of unsustainable bad debts. Countries embarked on the privatization of nationalized banks also as part of their general policy to enhance the role of the private sector.

For example, the entire banking system of the Republic of Korea was government-owned until the mid-1980s when the five commercial banks with nationwide branch networks were all privatized. In Bangladesh, two of six nationalized banks were transferred to the private sector during the period 1984-1985. Another public sector bank has been transformed into a joint stock banking company with 49 per cent share made available for public subscription and 51 per cent left for government ownership. India has allowed its public sector banks to sell up to 49 per cent of their equity to improve their capital position. In Pakistan, two of the five nationalized banks have been privatized and the Government is committed to privatizing the remaining ones.

Easing restrictions on entry of private banks

Private banks, both domestic and foreign, faced numerous strict entry restrictions in many countries. As a part of financial liberalization, these restrictions on entry were eased to promote competition among banks. For example, in Indonesia, the banking sector was dominated by five state commercial banks, with extensive branch networks and the exclusive right to receive public enterprise deposits. The reforms introduced in October 1988 dramatically lowered entry barriers.[12] Banking licences were made available to new banks that could meet new minimum capital requirements. The process for obtaining a licence for foreign exchange transactions was simplified. Freer opening of branches by domestic banks was allowed. Foreign joint-venture banks were authorized, with an extended branching network. Limitations on the activities which banks could undertake were lessened, and state enterprises were allowed to hold up to 50 per cent of their assets in private banks.

In Malaysia, the Philippines and Thailand, most commercial banks were traditionally privately owned. The Philippines banking structure used to be characterized by the presence of a large number of small private banks. Fearing the possibility of bank failures under this structure, during the 1980s the Government denied further permission to open banks and encouraged mergers and consolidation, leading to a significant increase in banking concentration. Regulations on new entry were relaxed in 1989 with many restrictions, however, still remaining. In Thailand, conditions for new entry and opening of new branches have been relaxed since 1990. Thailand established the Bangkok International Banking Facilities (BIBF), granting licences to 47 banks, both domestic and foreign, to accept deposits and lend in foreign currencies to both residents and non-residents, and engage in foreign exchange transactions. The objective has been to develop Bangkok as an international financial centre by increasing competitiveness and encouraging foreign participation.

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12 Donald P. Hanna, "The Indonesian experience with financial-sector reform", in *Finance and the Real Economy: Issues and Case Studies in Developing Countries*, Y. Akyuz and G. Held, eds. (United Nations University/World Institute for Development Economics Research, Economic Commission for Latin America and the Caribbean, and United Nations Conference on Trade and Development), p. 16.

Entry restrictions for private banks have been eased in most South Asian countries in recent years. Sri Lanka liberalized the entry of private banks much earlier in 1979. In Bangladesh, 11 private sector banks and a number of other financial companies have been established since the mid-1980s. In Nepal, five new commercial banks have recently been opened. Ten new commercial banks in the private sector have been allowed in Pakistan. India has permitted entry of private banks when they meet certain criteria.

Foreign banks and/or joint-venture banks existed in most countries of the region. However, their presence was restricted to a few branches in major cities. In some cases they were allowed to deal in foreign currency transactions only. To make domestic banks more competitive and efficient, the entry and scope of activities of foreign banks have been liberalized in a number of countries. For example, in the Republic of Korea, while the activities of foreign banks were largely restricted to foreign currency transactions, they are now given equal treatment with domestic banks. In Indonesia, foreign banks were limited to a maximum of two branches. Under the 1988 reforms, foreign joint-venture banks were authorized, with an extended branching network. Malaysia had a sizeable presence of foreign banks. However, since 1989 foreign banks are required to divest 50 per cent of their capital to Malaysian interests within five years. In addition, local branches of foreign banks will have to be incorporated in Malaysian banks. Thailand, in establishing the Bangkok International Banking Facilities, has actively encouraged the entry of foreign banks.

The economies in transition have also started implementing reforms in the financial sector. The relaxation of entry restrictions for private banks, including foreign banks, is a feature of reforms in those countries also (see box IV.1 for more details).

Improving prudential regulation of banks

While allowing banks more freedom to establish themselves, to open branches, to choose their portfolio of assets and liabilities, to manage risks, and to price their services (by setting the interest rates offered and charged), care has been taken to ensure that banks follow sound business practices and do not jeopardize the stability of the financial system through imprudence or malpractice. Many countries have recently enacted laws to strengthen the central bank's supervisory role over commercial banks. In particular, efforts have been made to ensure that banks have an adequate capital base. Most countries have set themselves target dates for achieving the minimum capital adequacy ratio (i.e., the ratio of capital funds to the aggregate risk-weighted assets) of 8 per cent, a norm prescribed by the Bank for International Settlements (BIS) for adoption internationally. Several countries in the region such as Indonesia, Malaysia, the Republic of Korea and Thailand had achieved the norm between 1993 and 1994. Indian banks which have branches abroad and foreign banks in India were to achieve it by 31 March 1994. Other banks were required to achieve a capital adequacy norm of 4 per cent in 1993 and 8 per cent by 1996. Many other countries in the region are moving in the same direction but are likely to find it difficult to achieve the 8 per cent norm in the near future.

In spite of the liberalization, banks in practically all countries are still prohibited from or restricted in the acquisition of certain assets, such as investing in real property, purchasing, trading, underwriting, and brokering of securities or advancing loans for stock trading. These activities are reserved for other specialized financial institutions, but some of these restrictions are being lifted as the other institutions gain in strength and experience (for details, see the section on the development of other financial institutions and markets). Restrictions are also placed on the borrowing from individual banks by their major shareholders such as governing board members.

The deregulation of the institutional structure for banks has led to a significant increase in the number of private domestic banks and branches in many countries. There has also been an increase in the number of foreign banks operating in many countries either independently or in joint ventures. Easing barriers to entry has in a few cases led to an increase in bank failures as banks did not have sufficient experience with the assessment of the viability of loans or were saddled with a portfolio of short-term assets and long-term bad debts with which they could not cope. There has also been a process of consolidation of small banks into fewer large ones in countries such as India and the Philippines. There are clearly significant economies of scale in dealing with loan portfolios and risk assessment under a liberalized system. In some countries, for example Thailand, major banks have been making large profits from their operations. This situation is likely to change with increasing competition in the provision of services, although banks worldwide are significant profit-making institutions. This again is associated with economies of scale in operations, the accumulation of experience as well as the development of a reputation with customers for good service, reliability and good advice.

Box IV.1. Development and reforms of the financial sector in the economies in transition

The role of the financial sector in the former centrally-planned economies was extremely limited. Currency was used as the principal means of exchange in household transactions. Practically all investment activity was carried out in the public sector to meet planned production targets with both fixed and working capital needs provided by the Government. Profits or surpluses of state enterprises were, in turn, transferred to the Government as revenue. Under these circumstances, the role of a bank was reduced to providing a bookkeeping service for both the Government and enterprises. The features of a modern financial sector such as the mobilization and allocation of resources for investment, the acquisition and provision of information, risk assessment and portfolio management were absent from the financial systems of centrally-planned economies.

As a part of their move towards a market-based economic system, economies in transition have started to establish financial institutions and infrastructure on the pattern of market economies. A major component of financial sector reforms has been the establishment of a two-tiered banking system, comprising a central bank and a group of other independent banks. The main function of the central bank is to look after the stability of the currency and to implement monetary policy. The other banks provide the services of commercial banks. In some countries they include specialized banks extending loans only to specific sectors of the economy. This transformation from a monobank system to a two-tiered banking system has been completed in all the economies in transition. In addition, the Central Asian republics issued their own national currencies after gaining independence.

Beyond the establishment of a two-tiered banking system, the level and speed of financial sector development have varied across the economies in transition. Private banks have been established in some countries. For example, by the end of 1992, Kazakhstan had 158 commercial banks of which 48 were private banks.[a] Uzbekistan had over 40 banks in mid-1994, including a few private banks. However, in most of these countries, a few big state-owned banks dominate the banking sector business. For example, in Kazakhstan the bulk of credit continues to flow through four specialized state banks, which together hold 80 per cent of the assets in the country's banking system. Similarly, in Uzbekistan corporate banking is dominated by two state banks with about 90 per cent of the total credit being allocated to state enterprises. The high degree of concentration is not conducive to competitive efficiency in the discharge of banking services.

To enhance competition among banks, restrictions on the entry of new banks can further be reduced with due regard for adequate prudential supervision. However, it may take new banks a long time to gain prominence and the confidence of users. As an alternative, some large state banks could be divided into smaller banks.[b] This could reduce concentration and improve competition. Privatization of some large state banks is another alternative. However, the privatization of banks which have huge stocks of non-performing loans owed by state enterprises, a feature common to most economies in transition, may not be feasible or even desirable because banks so privatized risk becoming immediately insolvent. Therefore, successful enterprise reforms are a major precondition for comprehensive financial sector reforms.

Realizing the fact that foreign banks can add to competition and can play an important role in the development of the financial sector in other ways as well, many economies in transition have permitted the entry of foreign banks. In Viet Nam, for instance, foreign banks have been allowed to open up branches since 1991. In addition, three joint venture banks with investment from Indonesia, Malaysia and the Republic of Korea were established by mid-1994. With their skills and experience, foreign banks or joint ventures can help in upgrading quickly the quality of financial services and can serve important training needs for local banks. Foreign banks, in turn, should consider employing and training local staff in return for market access.

Some progress has been made in bringing interest rates closer to market rates in a number of countries including Kazakhstan, Kyrgyzstan, the Lao People's Democratic Republic, Uzbekistan and Viet Nam. However, there are problems in the rapid liberalization of interest rates in economies in transition where markets in real sectors still remain subject to a high degree of uncertainty and volatility.

A number of requirements have to be fulfilled before comprehensive financial sector reforms can achieve their goals in economies in transition. Among these are: (i) stable macroeconomic conditions; (ii) solutions to the problem of a huge backlog of non-performing loans; (iii) preparation of required legal codes; and (iv) creation of a trained cadre of people able to meet the responsibilities of a market-oriented financial system. Most economies in transition will find it difficult to meet these criteria in the immediate future.

In order to prepare for comprehensive reforms, policy makers in transitional economies may consider it useful to start preparing legal codes, regulatory guidelines and enforcement mechanisms to oversee the financial market activities which are likely to evolve under reformed systems. Staff training for this purpose should begin at an early stage. Technical assistance from international organizations would be essential in implementing these steps.

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[a] N. Ordnung, "Economic reform in the Central Asian republics", paper presented at the Regional Seminar on Macroeconomic Reform in Disadvantaged Economies in Transition organized by ESCAP, 16-18 November 1994, Bangkok.

[b] G. Caprio, Jr. and R. Levine, "Reforming finance in transitional socialist economies", The World Bank Policy Research Working Paper WPS 898 (Washington, DC, April 1992).

Interest rate reform

A major element of reform in most developing countries in the region has been the progressive deregulation of interest rates and the curtailing of directed credit programmes, with interest rates on concessional loans being brought closer to market interest rates. Table IV.2 presents a summary picture of these reforms. Practically all countries in the region have adopted rather cautious step-by-step gradualism in removing restrictions on interest rates. The East and South-East Asian countries initiated the reforms earlier and have moved farther in removing control and liberalizing the rates. Countries in South Asia have initiated reforms relatively recently but have implemented them at a more rapid pace since 1990-1991. Some of the former centrally planned economies with completely state owned and controlled financial systems, such as China and Viet Nam, have attempted a complete overhaul of the system through a gradual process.

Table IV.2. Reforms affecting interest rates and directed credits

Country	*Deregulation of interest rates*	*Directed and concessional credits*
Bangladesh	The process of de-control began at the end of 1989 when the interest rate structure administered by the Bangladesh Bank was replaced by a matrix of interest rate bands for all the deposits and lending categories. In March 1992, the Government abolished the bands on most lending categories and lifted the ceiling on deposit rates. Floors for savings and fixed deposit rates remain.	Concessional lending rates existed for agriculture, exports and small-scale industries. However, at present low lending rates are fixed only for small and cottage industries.
India	Interest rates have been gradually deregulated since 1991. In October 1994, lending rates of scheduled commercial banks for credits of over 0.2 million rupees were freed. Rates are prescribed for credit limits below this limit to protect small borrowers. The Reserve Bank of India specifies a ceiling deposit rate, applicable to fixed deposits of maturities of 46 days and above. The Reserve Bank of India sets the savings deposit rate.	The number of designated lending categories was brought down from over 50 in 1989 to only 3 in December 1993. The target for priority sector lending (which includes agriculture and the small-scale sector) is still 40 per cent of gross bank credit plus an additional 10 per cent of total advances towards export credit. Foreign banks are required to devote over 30 per cent of credit to priority sectors. Since 1991, the element of subsidy in lending rates has been reduced.
Indonesia	Most interest rates were deregulated in 1983.	Directed and concessional credits were curtailed in 1983. Most subsidized credits were abolished in 1990. In place of them, the banks were asked to extend 20 per cent of their credit portfolio to small-scale companies. Foreign banks were required to extend 50 per cent of their credit to the export sector. Concessional credits were limited to four activities: rice production, marketing, maintenance of a buffer stock, and investment financing in the eastern part of Indonesia.
Malaysia	Up to 1978, the central bank used to set the lending rates for bank loans and the ceiling on deposit rates. In 1978, the commercial banks were permitted to determine their own interest rates for loans. Effective 1983, all interest rates on loans and advances were allowed to be tied to the banks' base lending rates, based on cost of funds. With effect from February 1991, the central bank freed the base lending rates from its administrative control.	Directed credits exist to promote some economic sectors and to achieve social goals. Ceilings on interest rates for such loans also exist to ensure credit at reasonable rates.

(Continued on next page)

Table IV.2 *(continued)*

Country	*Deregulation of interest rates*	*Directed and concessional credits*
Pakistan	From July 1985, banks switched from interest bearing deposits and loans to Islamic modes of financing and rates of return based on a profit-loss sharing approach. A regular auction programme of government debt has been initiated to switch from an administered interest rate setting to market-based interest rate determination.	A number of concessional credit schemes exist. Concessional rates were raised during recent years to narrow the gap between average lending rates and the concessional rate as well as to reduce the volume of directed credit. The share of subsidized credit in total credit was 36 per cent in 1992/93.
Philippines	Interest rate ceilings on all types of deposits and loans, except those on short-term loans, were removed in 1981. The interest rate ceiling on short-term loans was lifted in 1983.	The Government maintains the policy of directing credit to priority activities at below market interest rates. Special credit programmes for the Department of Social Services and Welfare carry below-market interest rates.
Republic of Korea	Interest rate liberalization was initiated in the early 1980s with a reduction in the differential between general loan rates and preferential loan rates. In 1984, banks were allowed to vary lending rates within margins. Ceilings on certain rates were eliminated. In 1993, interest rates on lending other than on policy loans and government funding, as well as those on long-term bank deposits (longer than 2-year maturity) were liberalized. Rates on policy loans will be liberalized between 1994 and 1995, while the rates for government funding and short-term deposit rates will be deregulated in 1996.	Prior to 1980, credit allocation was almost entirely directed by the Government to key industries. State intervention has since slowly been phased out.
Singapore	Nominal domestic interest rates are virtually identical to Eurodollar rates adjusted for the foreign exchange premium.	No priority sectors assigned by the Government.
Thailand	Ceilings on deposit and lending rates adjusted upward in 1980. Major reforms implemented in 1989-1992. The ceiling on commercial bank time deposit rates of over one year maturity was abolished in 1989. Ceilings on time deposit rates of less than one year maturity and on saving deposit rates were terminated in March 1990 and January 1992 respectively. The ceiling on lending rates for commercial banks and finance companies was abolished in June 1992.	Selected credit programmes for the agricultural and export sectors at concessional rates exist.

Sources: ESCAP, based on W. Tseng and R. Corker, "Financial liberalization, money demand, and monetary policy in Asian countries", International Monetary Fund Occasional Paper 84 (Washington, DC, July 1991), pp. 39-41; A. Nasution, "An evaluation of the banking sector reforms in Indonesia, 1983-1993, *Asia-Pacific Development Journal*, vol. 1, No. 1, (June 1994), pp. 63-90; A.H. Khan, "Need and scope for further reforms in the financial sector in Pakistan", *Journal of the Institute of Bankers in Pakistan* (Karachi, forthcoming 1995); M. Tang, "What China can learn from the financial market reforms in Asian developing countries", paper presented at the Seminar on China's Banking Reforms and Development, Shenzen, China, 2-6 November 1993; R.J. Chelliah, "Financial and fiscal sector reforms in Asian countries", *Asian Development Review*, vol. II, No. 2, 1993; A.H. Amsden and Yoon-Dae Euh, "Republic of Korea's financial reform: what are the lessons?", United Nations Conference on Trade and Development Discussion Paper No. 30 (Geneva, April 1990); and national sources.

Commercial banks and other financial institutions in the countries of the region now have much greater freedom in setting their deposit and lending rates. Governments and central banks in a liberalized system influence these rates indirectly through their open market operations, such as the auctioning of debt. Previously, government securities were sold to commercial banks at below market interest rates. Interest rates on government securities under a debt auctioning system are determined by market forces. These interest rates often play a guiding role for changes in other interest rates. Following the auctioning of newly issued government securities in a primary market, these securities can be traded in secondary markets, where the changes in their prices reflect changes in market interest rates. Secondary markets, however, are still in the early stages of development in most countries.

For example, as a step in the direction of interest rate liberalization in Pakistan, an auction system has been introduced for government securities, with commercial banks as the primary dealers. Two debt instruments, 6-month treasury bills and 3- to 10-year federal investment bonds have been introduced. Six-month treasury bills have been auctioned twice a month since March 1991. The development of a secondary market faces some impediments.[13] Government securities are also auctioned in a number of other countries including India, Indonesia, Nepal, the Philippines and Sri Lanka.

One impact of reducing the number of directed credit programmes and of eliminating concessional interest rates for special groups is to reduce the segmentation in the financial market and to make competition for funds more transparent and equal within a country. However, directed credit schemes have contributed to the development of some individual, especially disadvantaged, sectors of the economy and may continue to do so in the absence of more viable alternative means of promoting them. Nevertheless, it appears that for the reasonable functioning of the financial sector directed credit should not exceed a reasonably small proportion of the total credit extended.[14]

It could be expected that the reforms indicated above would have had a significant impact on the size of domestic savings. However, the mobilization of domestic savings is not a function of the interest rate only, but of a whole set of other factors as well, including the existence of a well developed, stable and efficient financial infrastructure. Nevertheless, the interest rate plays an important part in encouraging domestic savings through the banking system and in attracting foreign savings. After reform, interest rates were not expected to move in a uniform direction in all countries because the circumstances varied so widely. However, available data, which are presented in table IV.1, tend to suggest one thing in common: the real rate of interest for depositors, which was almost invariably negative in the early 1980s, became positive with very few exceptions by the mid-1980s. By this time many countries had adjusted the nominal rates upwards, although not necessarily freeing them completely for determination by the market. The rates have continued to remain positive well into the 1990s, but the value of the gains in the immediate aftermath of adjustments in the mid-1980s was eroded in most cases since the adjustments in nominal rates have apparently not kept pace with inflation rates.

It is possible to make only limited observations on the basis of available data about the impact of this positive interest rate incentive on the growth of financial savings in the region. Two sets of data are used in table IV.3, both of which are subject to many qualifications and require cautious interpretation. One set of the data indicate all forms of deposits including foreign currency deposits in financial institutions and the other, the money supply, M_2, as usually defined. Both are expressed as percentages of GDP as an indication of financial growth and depth in the economy.

The indicators point to two interesting developments. In four economies, Hong Kong, Malaysia, Singapore and Thailand, both indicators have values over 70 per cent. Singapore and Hong Kong are established international financial centres and the other two have aspirations in that direction. These ratios show considerable financial depth.[15] All the other countries except Fiji have ratios under 50 per

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13 For details see, Ashfaque H. Khan, "Need and scope for further reforms in the financial sector in Pakistan", *Journal of the Institute of Bankers in Pakistan* (Karachi, forthcoming 1995).

14 R.J. Chelliah, op.cit., p. 54.

15 The corresponding ratio of M_2 to GDP in 1992 for the United States of America was 66 per cent; for Japan, 107 per cent; for France, 97 per cent, for Germany, 66 per cent and for the United Kingdom of Great Britain and Northern Ireland, 96 per cent.

Table IV.3. Money supply and financial savings as a percentage of gross domestic product in selected economies of the ESCAP region

	1980	*1985*	*1990*	*1991*	*1992*	*1993*
Bangladesh						
Money supply (M_2)	20.4	28.2	31.8	31.8	32.9	34.0
Financial savings	16.2	23.8	27.7	28.1	28.7	29.3
Bhutan						
Money supply (M_2)	18.1 [a]	19.4	21.7	25.1	24.1	..
Financial savings	16.9 [a]	16.5	17.8	20.7	18.9	..
China						
Money supply (M_2)	37.4	57.2	83.0	92.1	101.3	95.8
Financial savings	..	33.2	51.4	57.6	63.9	59.2
Fiji						
Money supply (M_2)	34.1	37.2	48.3	52.0	55.2	54.7
Financial savings	26.6	32.5	44.1	47.8	50.8	50.2
Hong Kong						
Money supply (M_2)	70.4	217.3	460.6	501.4	527.3	579.9
Financial savings	63.4	204.5	439.7	479.6	503.2	551.6
India						
Money supply (M_2)	37.3	42.9	45.7	46.7	47.6	48.8
Financial savings	27.8	33.6	36.0	37.0	38.3	38.6
Indonesia						
Money supply (M_2)	17.0	23.9	43.3	43.7	45.7	50.1
Financial savings	12.0	19.1	38.5	39.5	41.1	..
Islamic Republic of Iran						
Money supply (M_2)	60.7	62.4	55.6	51.1	47.9	44.2
Financial savings	41.4	45.7	45.5	42.3	40.9	38.1
Malaysia						
Money supply (M_2)	51.5	63.1	66.2	69.2	78.3	88.4
Financial savings	40.2	54.0	56.4	59.8	67.1	76.9
Nepal						
Money supply (M_2)	23.7	29.3	33.4	35.2	34.0	37.4
Financial savings	14.9	20.0	23.0	23.7	23.6	..
Pakistan						
Money supply (M_2)	41.6	40.7	39.1	39.0	42.5	44.8
Financial savings	27.5	28.1	24.3	24.4	28.7	31.1
Papua New Guinea						
Money supply (M_2)	29.8	34.1	35.2	35.3	34.6	32.2
Financial savings	20.4	26.7	30.5	31.3	31.1	29.0
Philippines						
Money supply (M_2)	22.7	28.0	34.2	34.6	36.2	32.6
Financial savings	18.6	23.6	28.0	28.5	30.0	35.9
Republic of Korea						
Money supply (M_2)	32.9	34.8	38.3	38.8	40.0	42.3
Financial savings	28.0	30.8	34.5	35.2	36.5	37.9
Singapore						
Money supply (M_2)	64.0	72.3	93.5	95.2	95.8	92.3
Financial savings	51.5	60.1	82.7	84.9	85.3	82.2

(Continued on next page)

Table IV.3 *(continued)*

	1980	*1985*	*1990*	*1991*	*1992*	*1993*
Solomon Islands						
Money supply (M_2)	32.8	27.8	32.9	34.3	35.3	32.0
Financial savings	28.0	22.0	27.0	28.8	30.3	26.6
Sri Lanka						
Money supply (M_2)	32.0	31.2	28.5	30.2	30.8	32.5
Financial savings	25.2	24.4	21.1	22.9	24.1	25.8
Thailand						
Money supply (M_2)	38.0	56.2	69.8	73.1	75.4	80.1
Financial savings	31.0	50.0	63.4	67.0	68.9	73.2

Sources: ESCAP, based on International Monetary Fund, *International Financial Statistics*, vol. XLVII, No. 10 (Washington, DC, October 1994) and vol. XLVIII, No. 1 (Washington, DC, January 1995) and tape no. 94037F; Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries 1994*, vol. XXV (Manila, Oxford University Press, July 1994); and national sources.

Note: Financial savings comprises time, demand, savings and foreign currency deposits.

[a] 1983.

cent showing that financial depth has yet to be secured. Nevertheless, the change in the ratios since 1980 show that there has been sizeable growth in financial depth in several of these countries including Bangladesh, Fiji, Indonesia, Nepal and the Philippines, and it can be hypothesized that this situation will continue. There are a few countries, namely Bhutan, the Islamic Republic of Iran, Pakistan, Papua New Guinea, Solomon Islands and Sri Lanka, where financial deepening has been very slow, if occurring at all.

Most of the economies showing relatively fast rates of financial deepening are known to have achieved high rates of domestic savings and fast rates of economic growth. High saving rates may have resulted from high incomes and more thrifty habits of people rather than from the stimulus provided by high interest rates. However, significant positive real interest rates available since the mid-1980s may have attracted more of the savings into financial assets as reflected in their growth since then. The Republic of Korea appears to be an exception among the high saving and fast growing economies with a slower expansion in M_2/GDP percentage from 33 per cent in 1980 to only 42 per cent in 1993.

The costs to the users of finance as reflected in bank lending rates have tended to move in the same general direction as deposit rates (see table IV.1). In many cases, however, lending rates have not moved in parallel with inflation rates and the real cost of borrowing has risen.[16] Only Malaysia and Singapore seem to have kept the cost of borrowing relatively low and stable with their low and largely stable inflation rates.

Financial liberalization is expected to enhance the operational efficiency of the banking sector through enhanced competition. One measure of operational efficiency is the spread (or the intermediation margin) between the deposit rate and the lending rate. The intermediation margin can be affected by a number of factors, including the operating expenses of the banks, legal reserve requirements, inflation rates and the relative importance of non-performing loans in an institution's portfolio. Enhanced competition among banks should curtail operational expenses. Financial liberalization in general implied lowered reserve requirements, which should reduce the intermediation margin. However, higher inflation rates can increase the spread between deposit and lending

[16] A recent study on Indonesia concludes that shifting from administrative toward marked-based allocation of credit has increased borrowing costs, particularly for smaller firms, but, at the same time, has benefited firms by giving them wider access to finance. See John R. Harris, Fabio Schiantarelli and Miranda G. Siregar, "The effect of financial liberalization on the capital structure and investment decisions of Indonesian manufacturing establishments", *The World Bank Economic Review*, vol. 8, No. 1 (January 1994).

rates: to maintain real profits at the same level, the intermediation margin has to rise when inflation rises. In addition, the existence of significant non-performing loans can force banks to raise their intermediation margins to pay for the cost of liquidating these loans.

The spread between the lending and deposit rates in a number of countries has tended to widen at least for some years after liberalization (table IV.1). However, there is some evidence that intermediation margins have decreased in some countries after financial liberalization. In India, there was a sharp decrease in the intermediation margin in 1991 compared with 1990. Similarly, the intermediation margin declined in Malaysia in 1990 compared with 1985. Intermediation margins have also fallen in the Philippines and Thailand.

Stickiness in interest rates can be partly attributed to the oligopolistic nature of the banking industry as reflected in the high banking concentration ratio, notwithstanding the recent liberalization of entry and the licensing of new domestic as well as foreign banks. However, banks are beginning to face increasing competition from non-bank, non-intermediary financial institutions in the form of various money market funds as well as from the direct use of capital markets to raise business capital. This process of growing disintermediation of finance will likely force banks to offer more competitive interest rates as well as more efficient services.

Development of other financial institutions and markets

Rapid economic growth as well as financial liberalization has resulted in the rapid development of non-bank financial institutions and other financial markets and instruments. By the late 1980s the non-bank financial institutions accounted for 20-50 per cent of the total assets of the financial sector in countries such as Malaysia, the Republic of Korea and Thailand. Institutions, such as leasing companies, insurance firms, securities companies, pension funds and mutual funds are fast-growing segments of the financial system in most countries. However, their size as a group has remained relatively small in the total size of the market.

The services provided by financial institutions are becoming more diversified and distinctions between the various types of financial institutions are disappearing. Thailand provides one of the best examples of stimulating the development of an integrated system of financial services by permitting different categories of financial institutions to undertake similar types of activities and provide similar services, thereby blurring the traditional distinction between bank and non-bank financial institutions and creating conditions for a more competitive financial market. Non-bank financial institutions are permitted to engage in activities usually undertaken by commercial banks. At the same time, commercial banks are also allowed to engage in a variety of fee-based businesses, such as loan syndication, feasibility studies and consultations on merger and acquisition. Since early 1992, banks have also been allowed to underwrite securities issued by the government or public enterprises as well as to provide financial consultation and information services. Universal banking has been encouraged in the Philippines, where some of the larger banking institutions have been permitted to engage directly in the securities business, leasing and other financial activities.

An increasing array of financial instruments is now available to the investors in most countries. These instruments include government securities, open and closed-end mutual funds, certificates of deposit, commercial paper and various savings accounts with banks and non-bank financial institutions. An important money market instrument that has developed in recent years is the issuance by central banks of their own bonds/bills/papers, akin to short-term treasury bills. The central banks have made increasing use of these through the auction method of sale/purchase to attain market-determined discount rates as well as to influence the level of market liquidity. Commercial banks have also been permitted to hold these central bank bonds in lieu of their obligation to hold government treasury bills. Short-term money market instruments such as tradeable commercial papers and certificates of deposits have also been issued and traded in increasing volumes.

With deregulation and liberalization in both the financial and real sectors of the economy, there has been a significant shift by enterprises from loan to equity or bond finance. As a result, stock markets in many Asian countries have demonstrated dynamism and growth in recent years. Table IV.4 provides a summary of the developments in these markets. In terms of capitalization, stock turnover and returns, they have far outpaced the older

Table IV.4. Development of equity markets

Country	Year of establishment of stock exchange(s)	Growth of capitalization (billions of US dollars)		Gross foreign portfolio investment inflows (millions of US dollars)			Status of foreign participation	Regulatory agency
		1987	1994	1989	1992	1993[a]		
Bangladesh	Dhaka Stock Exchange revitalized in mid-1970s	–	–	–	–	19	Some registration procedures required to ensure repatriation rights	In 1993, legislation was passed to create a Security Exchange Commission which has been recently constituted
China	Shanghai and Shenzen Stock Exchanges established in late 1980s	–	50	–	2 276	4 837	As of March 1993, special classes of shares (B-shares) are available to foreign investors	China Securities Regulatory Commission
India	Several local stock exchanges exist. A National Stock Exchange under establishment	12	130	698	240	877	Only listed foreign institutional investors permitted to invest in capital market	Securities and Exchange Board of India established in 1988
Indonesia	Jakarta Stock Exchange revived in 1977	1	45	309	644	1 089	Since 1989 foreigners are permitted to invest in Indonesian public companies with 49 per cent limit	Bapepan (the Capital Market Supervisory Agency)
Malaysia	Kuala Lumpur Stock Exchange established in 1960	10	240	195	385	954	Listed stocks freely available to foreign investors since 1989	The Security Exchange Commission set up in March 1993
Pakistan	Karachi Stock Exchange established in 1948, Lahore Stock Exchange in 1970 and Islamabad Stock Exchange in 1992	–	13	–	11	5	Listed stocks freely available to foreign investors as of March 1993	The Corporate Law Authority regulates and supervises the capital market
Philippines	The Manila Stock Exchange and the Makati Stock Exchange merged in 1993 to form the Philippine Stock Exchange	3	14	253	353	1 357	Special classes of shares (B-shares) available to foreign investors as of March 1993	

(Continued on next page)

Table IV.4 *(continued)*

Country	Year of establishment of stock exchange(s)	Growth of capitalization (billions of US dollars)		Gross foreign portfolio investment inflows (millions of US dollars)			Status of foreign participation	Regulatory agency
		1987	*1994*	*1989*	*1992*	*1993*[a]		
Republic of Korea	Seoul Stock Exchange established in early 1970s	30	190	150	5 858	6 192	Beginning 1992 foreign investors allowed to buy Korean stocks subject to a 12 per cent ceiling	The Security Exchange Commission established in 1977
Singapore	The Stock Exchange of Singapore was formally separated from the Kuala Lumpur Stock Exchange in 1989	15	140	–	–	613	Foreign investors allowed to buy stocks of local companies and float their securities on Singapore stock exchange	The Monetary Authority of Singapore has extensive regulatory and supervisory responsibilities
Thailand	Stock Exchange of Thailand in its present form has existed since 1975	5	145	1 426	689	2 713	Since 1993 stocks of domestic companies available to foreign investors subject to 49 per cent ceiling. Some registration procedure required to ensure repatriation rights	In 1992, the Security Exchange Commission was established

Sources: ESCAP, based on S. Gooptu, "Portfolio investment flows to emerging markets", in S. Claessens and S. Gooptu, *Portfolio Investment in Developing Countries*, World Bank Discussion Papers No. 228 (Washington, DC, 1993), pp. 72-73; "Asian finance survey", *The Economist* (12 November 1994), p. 9; M. Goldstein and others, *International Capital Markets, Developments, Prospects, and Policy Issues* (Washington DC, International Monetary Fund, September 1994), pp. 126-127; and national sources.

[a] International bond and equity issues by the countries.

established markets of the world.[17] They have also become attractive to funds which use stocks and bonds as an alternative means of savings. These funds, which include mutual funds, pension funds etc. exist at the national level and are active on the local stock market. Funds from industrialized countries also invest in stock markets in many countries, including several in Asia. The average monthly trading value of Hong Kong's stock market, for example, increased by 267 per cent from 1991 to 1993 compared with a 50 per cent rise in the New York Stock Exchange and a decline of 11 per cent in the Tokyo stock market during the same period. The Singapore equity market is one of the most developed in the region, with a strong international orientation.

[17] The number of companies listed on stock exchanges has increased sharply in developing Asia during recent years. However, capitalization per company on average has remained very low compared with developed countries. See, for example, United Nations Conference on Trade and Development, "Regionalization and integration into the world economy: the Latin American experience in trade, monetary and financial cooperation" (UNCTAD/ECDC/234, 31 August 1994), p. 61.

In the Republic of Korea as the economy grew rapidly, the Government implemented various measures for the fast development of the capital market. A bar on big companies borrowing overseas forced them into the domestic capital market and the enforcement of debt-equity ceilings for firms led to an increased supply of corporate stocks. Along with allowing tax breaks for investment in the capital market, a country-wide campaign to educate the ordinary investors about the capital market was launched to enhance demand.[18] Measures were taken by the Government to reduce insider trading and improved disclosure. From 1992, foreigners were allowed to invest directly in the stock market up to 10 per cent (enhanced to 12 per cent in 1994) of total outstanding issues, with the exception of public utilities and strategic industries in which foreign participation is set at a lower limit.

The capital market in Malaysia is also well developed. To a large extent, these developments reflected measures undertaken by the Government to liberalize the capital market while, at the same time, putting in place the necessary institutions, instruments and the legal and administrative framework. Trading on the Kuala Lumpur Stock Exchange in 1993 exceeded the amount of total trade undertaken during the previous 20 years in terms of both volume and value of transactions. In terms of capitalization it is currently the fourth largest market in Asia.[19] An important development with regard to the capital market was the setting up of the Securities Commission in March 1993 to oversee the overall orderly development of the market. The introduction of financial futures and options followed the enactment of the Future Industry Act, 1992, which set out the legal framework to ensure the protection of investors and to enhance confidence in the market through the establishment of minimum standards within which the financial futures and options market should operate. The development of the financial derivatives market is also under the jurisdiction of the Securities Commission.

In Thailand, the equity market has been growing rapidly since the mid-1980s. Capitalization as a ratio to GDP rose from 4.8 per cent in 1985 to 38.3 per cent in 1991.[20] The passage of the 1984 Securities Exchange of Thailand Act, which, *inter alia*, tightened controls to ensure fair trading, contributed to the improved performance. The Securities Exchange Commission was established in 1992 as a central agency overseeing almost every aspect of the capital market, thus streamlining the previous supervisory roles of several agencies. Among more recent improvements are the introduction of a computerized trading system, improvement of the clearance and settlement systems, and a better information system.

India's stock market has grown rapidly during recent years. To improve regulation and investor protection, the Securities and Exchange Board of India was established in 1988; measures were introduced to tighten issuing conditions, to computerize trading and to establish automated settlement of transactions. Market capitalization of the Bombay Stock Exchange rose over threefold to 22 per cent of GDP over the five years to the beginning of 1992.[21] However, in May 1992 irregularities in securities trading were disclosed which highlighted the need for further regulatory reforms. The equity market in India was opened on a restricted basis to non-resident and foreign institutional investors in September 1992.

In Pakistan, the capital market is of a small size. Between 1990 and 1992, the market valuation of listed companies increased sixfold and the number of listed companies rose by 27 per cent. A significant easing of foreign investment rules in 1991 opened the market to foreign investors. Foreign investors can now own up to 100 per cent equity in a venture and can purchase equity in industrial companies on a repatriable basis.

The establishment of a single agency responsible for the development and regulation of the capital market has been a significant step in many countries to put their stock markets on a sound footing. As indicated in table IV.4, Securities and Exchange Boards/Commissions have been set up to

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18 The need to stimulate local investors to trade on the local exchange has also been recognized in Indonesia where it is estimated that foreigners provide 80 per cent of the turnover in the trading of shares of domestic companies. See "Government moves to correct lopsided Jakarta stock market", *Financial Times*, London/Jakarta, reproduced in *Bangkok Post* (13 December 1994), p. 27.

19 Bank Negara Malaysia, *Annual Report 1993* (Kuala Lumpur, 1994), p. 190.

20 Asian Development Bank, *Asian Development Outlook 1993* (Manila, Oxford University Press, 1993), p. 53.

21 Ibid., p. 54.

administer the set of rules and regulations governing stock market activities, replacing multiple regulatory agencies in many cases. Legislation has also been enacted to remove loopholes and set standards to eliminate or minimize malpractice, and to ensure fuller disclosure of information and stable trading conditions.

Private debt securities markets are also growing, with corporate bond markets in the initial stages of development in many countries of the region.[22] In India, Malaysia, the Republic of Korea and Thailand these markets have grown to moderate sizes. An important factor hampering the growth of the corporate bond market is their high credit risk – the possibility that coupon payments and/or principal repayments may not be made on time or at all. There is thus a need for independent reliable information on the risks inherent in different corporate bonds. Independent credit rating agencies for corporate bonds have been established in recent years in a number of countries, including India, Indonesia, Malaysia, the Philippines and Thailand. A common critical challenge being faced by these agencies relates to building or improving capacity to conduct internationally acceptable credit analysis. The function of credit rating is quite complex, and it is made much tougher by lower standards of accounting and disclosure in this region compared with those in developed economies. In addition, these markets need benchmarks against which new issues can be valued. Such benchmarks can be provided by the issuing of bonds by the Government or state enterprises.[23]

There is also increasing interest in the region in using financial derivatives such as swaps, options and futures. These new financial instruments have proliferated in international capital markets primarily to facilitate hedging against price, currency and other risks. However, the use of derivatives can be for speculative purposes and can result in huge losses. Also the underlying technical conditions for trading these instruments are often not sufficiently developed to permit the establishment of liquid contracts. While developing countries have been cautious in permitting their use, derivative markets exist in the relatively advanced money centres such as Hong Kong, Malaysia, Singapore and Thailand.

External financial liberalization

Financial liberalization has been carried out in both domestic and international markets with policies of financial openness greatly contributing to the rapid growth of foreign exchange markets in many developing countries. External financial liberalization policies include decontrol of foreign exchange transactions on the current account, making exchange rates flexible and removing or easing of restrictions on capital flows between countries. Aspects of capital account liberalization include allowing banks and businesses to borrow offshore in foreign currencies,[24] opening the domestic financial market institutions and instruments to foreign participation, and allowing domestic institutions to establish foreign branches or affiliates. With the adoption of openness in financial policies by a growing number of countries in the world, the provision of investment finance is increasingly becoming an integrated global industry. It is argued that the benefit of financial openness is that it allows savings to be pooled and allocated globally through the movement of capital among countries in response to opportunities for real investment, thereby improving the allocation of resources internationally and equalizing rates of return on investment everywhere. At the same time, this financial openness has made the management of the financial sector and monetary policy a very difficult task. This issue will be taken up in somewhat greater detail later in the chapter.

The Republic of Korea adopted a flexible exchange rate system in 1980. Controls on capital movements were relaxed in 1987 and 1988 to permit capital exports in the presence of comfortable current account surpluses. With the current account returning to a deficit in 1989, controls were reinstituted. Domestic firms were prohibited from borrowing abroad and capital flows of a speculative nature were strictly controlled.[25]

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22 In the United States, 45 per cent of companies' funds are raised through the corporate bond market; in developing Asia the figures are less than 1 per cent. "Asian finance survey", *The Economist* (12 November 1994), p. 12.

23 For a discussion on this issue see, "Experts advise government bonds to develop debt instrument market", *Bangkok Post* (8 December 1994), p. 23. It is suggested that by the turn of the century the value of the local debt instruments market capitalization could be as large as that of the local stock market.

24 It has been argued that borrowing from the international bond markets, which specialize in long maturities, will be one principal way of financing the planned large infrastructure development in Asia. *The Economist*, op. cit., p. 12.

25 A.H. Amsden and Yoon-Dae Euh, "Republic of Korea's financial reform: what are the lessons?", United Nations Conference on Trade and Development Discussion Paper No. 30 (Geneva, April 1990), p. 23.

In Indonesia, as early as in 1970 the exchange rate was freed and control on access to foreign exchange abolished. The surrender of export proceeds was no longer required and purchase or sale of foreign exchange could be made freely. Foreigners and Indonesians were free to open accounts in foreign currencies with the banks authorized to deal in foreign exchange transactions and capital inflows were freely allowed. In the Philippines, the current account transactions were liberalized in 1991. Repatriation of foreign investment and remittance of foreign investment income were also permitted without any restriction. In Thailand, commercial banks have been allowed since 1990 to engage in foreign exchange transactions related to import and export of goods and services without prior approval from the Bank of Thailand. A freer transfer of capital was permitted in 1991, with some exceptions (for example, for the purchase of foreign exchange to buy foreign real estate and securities) where permission from the Bank of Thailand was still required. The regulations concerning the opening of foreign currency accounts have also been relaxed.

In all South Asian countries, currencies have largely been made convertible on current account and exchange rates have been allowed to float in the market. Full convertibility of the currency on capital account has also been under consideration to encourage capital flows. In India, automatic approval of foreign equity ownership of up to 51 per cent in 35 priority industries has been allowed since July 1991. Foreign equity up to 100 per cent is allowed in power, electronics and software technology parks, and 100 per cent export-oriented units. Free repatriation of profits of foreign firms has been permitted. In 1992, the Government allowed private and public Indian firms in good financial standing to raise funds abroad. Pakistan adopted a managed floating exchange rate system in 1982, and foreign exchange controls have largely been liberalized. Pakistani firms as well as individuals can now open and maintain foreign currency accounts in Pakistan, a facility which was restricted beforehand to foreigners and non-residents. Foreigners and overseas Pakistanis have been allowed to make new investments without any prior approval, except in a few industries of security and social importance. Foreign investors can now own up to 100 per cent of equity in a venture and can purchase equity in existing industrial companies on a repatriable basis. Remittance of dividend and disinvestment proceeds no longer requires the central bank's permission. Access to borrowing by foreign companies and the rules governing domestic private sector foreign borrowing have been greatly liberalized.

The situation in several of the Pacific island countries is quite different. Some do not have national currencies and others have established offshore financial centres in order to develop a new way of generating foreign exchange revenue. Details of the unique situation in these countries are highlighted in box IV.2.

One favourable consequence of the relative openness of the financial sector has been an acceleration of foreign private capital inflows into the region. The developing countries of the ESCAP region have been the largest recipient of private capital flows among all developing countries worldwide and most countries have experienced a surge in these flows in recent years, although the rate of growth and the volume of receipts differed considerably among countries (see table IV.4). Rapid rates of economic growth amidst macroeconomic stability already gave foreign investors confidence to invest in the region. The recent liberalization moves, especially the partial opening of the region's stock markets for foreign portfolio investment, the participation of foreign security houses and dealers and the higher profitability of investment in the region, have given a further boost to confidence.

From the above discussion it is clear that while most countries in the region are in the process of reforming their financial sectors, they still need to complete this process. There remains a large scope for strengthening and consolidating these reforms, especially in the areas of prudential measures and regulation, accounting practices and the provision of information to regulators and potential investors.

IMPLICATIONS OF REFORMS AND RELATED POLICY ISSUES

As the financial sector is closely interrelated with the real economy of a country (and with the conduct of its monetary and fiscal policies), its reform should ultimately have a positive impact on the real economy influencing, *inter alia*, the growth and structure of production and of trade. The mobilization and allocation of savings through the financial system are intermediate processes: their role is ideally to keep the costs of borrowing financial resources low while encouraging, or at least not discouraging, savings. This balancing act, it is contended, is not easy to perform on the basis of any pre-set calculations but is best done through a competitive market mechanism. This mechanism, however, has limitations and, as discussed earlier in this chapter, market failures are not unusual in

Box IV.2. Financial sector reforms in the Pacific island countries

There are marked differences among the Pacific island countries with regard to the development of their financial sectors. There are some very small countries which do not have their own national currencies or central banks. As a result, they cannot use independent interest rate or exchange rate policies. In larger countries, the financial sector is relatively more developed. They, like other developing countries, have been pursuing financial sector reforms. The need for these reforms has become more pressing as the dominant role of the public sector in the economies of these countries shrinks and that of the private sector expands. An efficient financial sector can help in meeting the growing needs of the private sector for financial resources.

Small island countries including the Cook Islands, the Federated States of Micronesia, Kiribati, the Marshall Islands, Niue, Palau, and Tuvalu do not have central banks and do not, except for the Cook Islands, issue their own currencies. The Federated States of Micronesia, the Marshall Islands and Palau use the United States dollar, Kiribati and Tuvalu use the Australian dollar while the Cook Islands and Niue have the New Zealand dollar in circulation. The Cook Islands does have its own dollar which circulates along with the New Zealand dollar within the country. Currently, parity is maintained between the two currencies. But the country is facing difficulties in keeping its currency in circulation. It has a currency board arrangement under which a 100 per cent backing in convertible New Zealand currency was originally required by statute. Stability of the currency was maintained, but when the Government amended the statute and reduced the backing to only 50 per cent, difficulties emerged. Compounded by the ongoing fiscal deficit, largely financed by printing the Cook Islands dollar, confidence in the local currency has evaporated and liquidity in the banking system has dried up as members of the public have tended to abandon the local currency. The Government has announced its intention to purchase all the Cook Islands dollars in circulation and embrace the New Zealand dollar as the only legal tender.

The interest rates which prevail in the above seven countries closely reflect those in the countries whose currencies circulate domestically. The financial institutions which operate in these countries include development banks, commercial banks either wholly owned by overseas owners or as joint ventures with government or local entities, insurance companies and, in two of them, provident funds. Capital markets are relatively underdeveloped.

Other Pacific island countries including Fiji, Papua New Guinea, Samoa, Solomon Islands, Tonga, and Vanuatu have central banks. The financial institutions in these countries in general include commercial banks, development banks, national provident funds, life and general insurance companies and housing finance companies. Fiji is currently the only one with a fledgling stock exchange.

A few countries have been actively promoting offshore banking to generate revenue in the form of registration fees and other charges. Vanuatu has the most active offshore finance centre in the Pacific subregion. The centre is exempt from all direct taxes including personal income tax and enjoys the protection of secrecy provisions in the laws of Vanuatu. The financial activities in the centre are run by exempt banks, trust companies and accounting and legal firms. These entities are supervised by the Financial Services Commission and not the Reserve Bank. But coordination between the two institutions is maintained through the Governor of the Reserve Bank who sits as a member of the Financial Services Commission. The exempt banks are not allowed to accept deposits from or lend to residents. This ensures that the domestic economy is insulated from the financial transactions which they undertake. These offshore banks act as booking agents and funds do not physically flow into and out of Vanuatu through them. The Government estimates that it earns more than $1.5 million in registration fees and other charges from the centre and some $2.5 million in net foreign exchange receipts annually. The prospects for the future growth of the centre are good. Both the tax haven image which Vanuatu projects and favourable time zone, sitting as it does between East Asia to the west and North America to east, have contributed to the rapid development of the offshore finance centre. The Cook Islands has also developed an offshore bank centre. As in Vanuatu, institutions in the centre operate as booking agents and funds do not physically enter or leave the country. Taxation and secrecy provisions are embedded in national legislation aimed at attracting overseas entities into this increasingly competitive line of business.

Interest rates have been deregulated in some larger countries with more than one commercial bank and where competition among these may be safely assumed to exist. In Fiji, for instance, interest rate deregulation began in 1981 and by 1987 interest rates had been completely deregulated. In Papua New Guinea, interest rates on loans and advances and on deposits were deregulated in 1993. Similarly, lending and deposit rates are no longer regulated in the Solomon Islands.

In many Pacific island countries, the use of selective credit control is progressively being reduced and reliance upon market-based monetary policy instruments is growing. Increasingly monetary intervention is pursued through the sale and purchase of government securities. To assist further in this process, central banks have started issuing their own securities. The securities issued by the Government and central bank are taken up mainly by the banks which may discount them with the central bank when the need arises. Ultimately open market operations are becoming the main tool of monetary policy. As an

(Continued overleaf)

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illustration, earlier the Reserve Bank of Fiji relied heavily upon selective credit control and variation in required reserves in its monetary management. But indirect market interventions have increasingly become important. All securities, including treasury bills, bonds and promissory notes issued by the Government, the Reserve Bank and public sector enterprises are now regularly put out on tender. The Reserve Bank rediscounts these papers from banks in an attempt to support a secondary market for them. These securities are also increasingly bought and sold on the stock exchange.

Prudential measures and regulations play an important role in the sound development of the financial sector. Most countries have a set of basic prudential measures and regulations and they are continuously making improvements in them. For example, the capital adequacy guidelines recommended by the Bank for International Settlements are now being observed in Papua New Guinea. Supervisory and regulatory functions are usually performed by the central banks. Their capacity for effective implementation of prudential measures and regulations needs to be further strengthened.

the finance area.[26] While government intervention intended to address these failures had several adverse consequences and a general atmosphere of financial repression was sensed to have prevailed, increased reliance on market mechanisms has not led to a complete resolution of these market failures. In addition, some new concerns have arisen connected with increased inherent instability, more demanding forms of transparency, accountability and supervision and a more indirect and difficult conduct of monetary and exchange rate policies.

The usual presumption is that more savings will lead to more investment which, in turn, will lead to higher production and growth of an economy. The developing countries of the ESCAP region have had a variety of experiences in this regard. It could be argued that the relatively liberal financial atmosphere in countries of East and South-East Asia has been a factor encouraging the high rates of savings and investment and that the greater efficiency of their payment and transaction systems assisted these economies in achieving high rates of economic and trade growth. While that may be so, it has also been found that high rates of savings, investment, and economic and trade growth were achieved by countries with financial systems which would normally be judged as repressed. For example, on the one hand Japan and the Republic of Korea in the early phases of their development, as well as China in recent years, had extensive programmes of directed credit as well as regulations and restrictions on the freedom of the financial sector and yet they have achieved some of the fastest rates of economic growth and development in the world. On the other hand, the Philippines with its relatively open and liberal financial system was less successful as were countries in South Asia which also administered similar programmes of directed credit with similarly heavy regulatory regimes governing their financial systems. As a result of such contradictory experiences, questions have been raised as to whether financial liberalization is either a necessary or sufficient condition for successful economic growth and development.[27]

In this regard, the experiences of the countries that have undertaken financial reforms show that a stable macroeconomic environment is an essential precondition for the reforms to function, as "reforms carried out against an unstable macroeconomic background can make that instability worse".[28] High and variable inflation rates can make interest rates, especially real interest rates, very high and unstable after their deregulation. Moreover, the spread between deposit and lending rates can widen. This situation can be a disincentive for savers and cause insolvency for enterprises as well as financial institutions. In addition, deregulated interest rates in combination with a flexible exchange rate can result in extremely volatile capital flows. Most of the rapidly growing economies in Asia undertook both fiscal and real sector reforms before financial ones. Under structural adjustment programmes, some countries in the region, especially in South Asia, introduced trade, fiscal, financial and other reforms more or less simultaneously. Other countries such

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[26] For examples of market failures, see J.E. Stiglitz, "The role of the state in financial markets", *Proceedings of the World Bank Annual Conference on Development Economics*, 1993, pp. 23-32, and Mihir Rakshit, "Issues in financial liberalization," *Economic and Political Weekly* (24 September 1994).

[27] See, for examples, the discussion in Akyuz, op.cit., on the benefits of keeping some controls.

[28] World Bank, *World Development Report 1989* (Washington, DC, Oxford University Press, June 1989), p. 127.

as Indonesia brought financial sector reforms ahead of real sector reforms. It can be concluded that the appropriate approach is significantly dependent upon the political system, economic structure and the administrative capacity of the individual countries. However, it is generally agreed that the real sector should be reformed first so that it can transmit the appropriate price signals. When prices are distorted because of protection or price controls, financial reforms can have a limited impact on the allocation of resources, one of its key objectives. Within the nexus of financial reforms, it appears that most can be done together except that domestic financial reforms should precede relaxation of controls over international capital flows. This is necessary because when domestic interest rates are controlled and low, capital account reforms can lead to a massive outflow of capital.

As the process of reforming the financial sector in Asian countries is likely to continue, the focus of attention has switched to problems concerned with the consolidation of reforms and with their consequences. While no country in the world has totally deregulated its financial market, it is important to distinguish between government interventions that lead to inefficiencies and misallocations of resources and those which are designed to support, supervise and exercise prudential control to correct market failures and maintain systemic stability. Governments can and must assume an important role in maintaining public confidence in financial institutions and instruments.[29] In this context, the implications of recent reforms for government policies can be grouped into three categories, those concerned with the attainment of greater equity and other social goals, those concerned with increased domestic exposure to risks of instability and insolvency and those concerned with the conduct of monetary policy and the consequences of growing integration into global financial markets.

It is interesting to note (see table IV.2) that with reform, most Governments have maintained some special programmes of directed and/or subsidized credit for specific disadvantaged groups in the economy such as agriculture or small-scale enterprises. This is because a liberalized system may lead to a socially unacceptable distribution of credit. Disadvantaged groups may not have access to credits through regular channels for the following reasons: (a) remote physical location; (b) rules on collateral which they cannot meet; (c) the small amount of credit they apply for being inefficient for banks to handle; or (d) interest rates beyond their means. The challenge is to design programmes for these groups which are based on market principles, not accessible by others and which do not interfere with the regular market. Some examples of innovative approaches to this problem for women and rural communities are presented in box IV.3.

Governments also need to be concerned about the implications of financial liberalization for their conduct of fiscal policy. They cannot finance increased fiscal deficits through government borrowing without raising market interest rates through their sales of securities or crowding out private investment. Therefore, they are placed under increased constraints to keep fiscal deficits manageable and to find other ways of raising government revenue, such as taxes. These constraints have direct implications for the achievement of social goals and for income distribution.

One consequence of a more market-based system is an increased exposure to various forms of instability. Under a regulated system the Government itself absorbs most of the costs of instability. After liberalization the actors in the system are individually and collectively exposed to the risks associated with unpredictable changes in prices, interest rates, exchange rates etc. and they have to learn how to function under these circumstances. This is an important step to be taken in order for the public to retain confidence in the financial system and to be willing to use it. The problems that arise can be illustrated by the following examples.

First, there is likely to be an increased exposure of financial institutions to insolvency. The new easier entry for financial institutions, including banks, provided for in the liberalization process can lead to a proliferation of financial institutions. Many of these may not have the requisite resources, experience or competence to operate on a sound actuarial basis or be able to carry out satisfactorily functions of risk assessment for loans. They may accumulate unbalanced portfolios of assets and liabilities, an unsustainable set of non-performing loans and so may collapse. The Philippines' experience earlier with too many banks unable to capture sufficient economies of scale, potential failures and threats to the stability of the system, and later

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29 See the discussion on this issue in Vicente Galbis, "Sequencing of financial sector reforms: a review", International Monetary Fund Working Paper (WP/94/101) (Washington, DC, September 1994), pp. 5-8 and 19.

Box IV.3. Formal financial institutions and credit to the poor: evolving new approaches

Past experiences of formal financial institutions in extending credit to the poor, predominantly through subsidized credit programmes, have often been disappointing. Nevertheless, there is a growing realization that the use of the existing wide network of the formal financial institutions, particularly banks, may be the best way to reach the poor on a sufficiently large scale. This would, however, require fundamental changes in the design and implementation of credit schemes as the banks have often considered the past schemes impracticable and too expensive. Forging links between formal banks and non-governmental organizations could be an important element in the new schemes.

The principal rationale of the directed credit programmes, as implemented in the past, was that subsidized access to financial resources would boost the income-generating possibilities of the disadvantaged groups. But, in practice, most of the directed credit programmes had low repayment rates and little impact on boosting income levels. The main reasons for this situation have been poor identification of clients or activities, cumbersome and time-consuming loan procedures, the lack of infrastructural support and marketing services for income-generating activities and an insufficient understanding that high transaction costs and collateral requirements were more important deterrents to the poor than the price of credit *per se*. These disappointing experiences coupled with strong internal and external pressures on Governments and banks to deregulate and strengthen the efficiency of the financial sector have basically marked the end of most poverty alleviation policies based on subsidized directed credit.

Nevertheless, an ever-increasing number of experiences in the region indicate that formal financial institutions can and should play an important role in providing credit to the poor. A wealth of experience regarding successful models of providing credit to poor and very poor clients has been amassed by financial institutions. These include innovative commercial banks, usually specialized operations within larger financial institutions; intermediaries which "retail" credit from banks to small borrowers; parallel programmes providing financial services without links to the formal banking system; and development banks that provide both social and financial services, for example, Grameen Bank of Bangladesh.[a] Notwithstanding the vital role already played by such institutions, their limited coverage compared with the needs of the poor calls for a vastly increased involvement of formal financial institutions.

Critical features of successful credit programmes for the poor include ways of reducing transaction costs for both lenders and borrowers through group formation and group collateral; charging commercial rates of interest to make the programme self-sustaining and to avoid the impression that credit is provided as a charity which does not have to be repaid; establishing deposit facilities; and targetting poor clients, not poor sectors.[b] One possible way of operationalizing the key components of successful credit delivery programmes is to develop close cooperation between formal banks and non-governmental organizations or community based self-help organizations. These organizations could act as intermediaries in the identification of clients, formation of groups, disbursement, repayment and monitoring of credit and, where necessary, the organization of business and other training.

This approach has already been implemented in some countries of the region. For example, the Rastriya Banyiya Bank, a state bank in Nepal has been cooperating closely since 1991 with self-help organizations in 19 project areas. The Bank had by early 1994 disbursed some 4.86 million rupees in credit either directly to the client upon recommendation of the self-help organizations, or to those organizations which disbursed the credits to the ultimate loanees.[c] Since 1989, Bank Indonesia has implemented a credit scheme titled "Project Linking Banks with Self-Help Groups". By September 1994 a total of 13,110 million rupiahs had been disbursed as loans through 1,659 self-help groups to 66,120 members. Repayment rates were 96.5 per cent and a total block savings of 2,198 million rupiahs had been deposited.[d] Similar experiences can be found in Bangladesh and the Philippines. Thus, linkage between non-governmental organizations and formal financial institutions can be an important step in efforts towards wider coverage of the poor under credit schemes without compromising the financial viability of the credit institutions.

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[a] See Sharon L. Holt and Helena Ribe, "Developing financial institutions for the poor and reducing barriers to access for women", World Bank Discussion Papers No.117 (Washington, DC, 1991).

[b] Ibid.

[c] Foundation for Development Cooperation, National Workshops on Banking with the Poor, "Reports of workshops conducted in seven Asian countries in 1993 and 1994", Brisbane 1994, p. 27.

[d] Cooperative and Small Scale Credit Department, Bank of Indonesia, "PHBK: An implementation of the linkage program in Indonesia", prepared for the Third Asia-Pacific Regional Workshop on Banking with the Poor, Brisbane, 21-25 November 1994, p.3.

moves to their consolidation and rationalization in a smaller number of institutions, is one example of this phenomenon. The United States savings and loans scandals of a few years ago is another. While not ignoring the need to promote healthy competition in the financial structure, it is also incumbent on Governments to provide a transparent and sound set of prudential regulations for the establishment and operation of financial institutions. Such regulations include not only reserve requirements but also accounting and disclosure standards, and require having well-trained officials capable of implementing them. These will naturally restrict entry to those who can meet the prerequisites and so indirectly encourage a fairly oligopolistic structure. They may also include a suitable mechanism for formally handling the issue of non-performing loans through banking courts, which already exist in a number of Asian countries. All these cost time and money but will eventually entail lower costs to the economy than a rush of fly-by-night, financially unsound institutions.

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

The third example concerns instability generated through the capital markets. Domestic capital markets in the Asian region have exhibited rapid growth in recent years and several have succeeded in attracting a large number of both domestic and foreign participants. Their growth has been generally welcomed for several reasons, including savings on intermediation costs involved in raising business capital and broadening the industrial capital and asset ownership. Stock markets are, however, well known for booms and busts largely unrelated to market fundamentals. Such movements are often caused by speculative runs and recently have tended to be exaggerated by the activities of investment funds which make decisions based on computer programme signals. Several funds operating on one market and using similar signals can cause large swings to occur in a short period of time.[30] Such swings can also occur when a market is "thin", i.e., there are not enough actors trading so that the actions of any one can have a large influence on prices, or when "insider trading", that is trading by market participants with inside knowledge of events, is not well controlled. There have been several instances of such speculative movements in the markets in the region. They cause not only unexpected losses to market participants, but create a crisis of confidence leading to reduced trading. Many countries have recently installed institutional and legal frameworks to control such situations or to prevent them from arising (see table IV.4). In the end the success of any capital market is very dependent on its set of supervisory rules and monitoring systems. It is interesting to note that the first meeting to exchange experience among regulatory agencies of stock markets of the Asian region was held in August 1994.

A related issue concerns the viability of stock markets in small economies. Practically all countries in Asia have the intention of having their own stock market and yet in several countries, the number of different companies for which stocks have or can be issued is very small. There appears to be a minimum number of around 20 below which the market is too thin for representative trading (spreads are too large and prices too volatile) or to make the market attractive to brokers to conduct business. In cases where meeting this minimum is not feasible, Governments should consider whether their firms which wish to issue shares should be encouraged to do so on the market of a neigbouring country or whether subregional stock markets should be developed. While this would entail considerable policy coordination between the countries concerned, it would encourage fewer, more robust stock markets in the longer run.[31]

One of the challenges resulting from liberalization and deregulation in the financial sector is how to cope with increasing integration into the global

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[30] Both local and foreign funds can cause such swings. In Thailand, the sharp decline in December 1994 was imputed to have been started by sales by foreign institutional investors but exaggerated by sales by local funds. See "SET reels 33 points", *Bangkok Post* (3 December 1994), p. 15.

[31] For a discussion of these issues, of recent progress in the development of regional stock markets and of the preconditions necessary for these to function, see United Nations Conference on Trade and Development, "The role of regional capital markets in enhancing resource mobilization and in promoting their efficient use" (UNCTAD/ECDC/246, 31 August 1994).

financial system and the increasing interdependence of this system itself. For example, differentials in real interest rates between countries have become a deciding factor in determining the investment of short-term money flows and changes in these differentials between domestic and foreign markets can cause large movements of funds. The recent increase in interest rates in the United States and the immediate negative effect on all stock markets in Asia is a good example of this phenomenon.[32] This can have large destabilizing effects on the exchange rates, domestic money supply and consequently on prices, thus making the situation difficult for monetary authorities in many countries to manage. The destabilization effects of such flows of funds on the balance of payments can also be severe. The induced movement in the exchange rates can have substantial effects on a country's export and import trade unrelated to any real economic change. It appears that Governments can try to influence exchange rates or inflation/interest rates but not both simultaneously without deleterious consequences.

Several countries in the region have experienced volatility in short-term capital flows caused by either domestic or external policy changes, obliging central banks to intervene in efforts to neutralize their destabilizing impacts.[33] Such measures have required the central bank to incur unexpected costs, such as those involved in issuing bonds to mop up extra liquidity from the financial system. In addition to bond issues, central banks have used other means, such as high reserve requirements on the foreign liabilities of domestic banks, limits on their net foreign currency position or gross foreign currency liabilities.

The kind of problem that countries have to face can be exemplefied by the experience of Bank Negara Malaysia in 1993-1994. In the face of strong inflows of speculative capital in anticipation of gains from interest rate and exchange rate differentials, Bank Negara Malaysia in its efforts to stabilize the domestic money and foreign exchange markets incurred significant losses.[34] Another example is India where official foreign exchange reserves were built up to $20 billion by 1994 from as low as $1 billion in 1991. This rapid build-up within a short period was largely the result of large capital inflows into the country. While this has greatly relaxed the severe foreign exchange constraints that the country came to encounter in 1991, it has also made it difficult for the central bank to achieve its target of monetary growth and inflation rates set at 16 percent, and around 6 per cent respectively, in 1994. The Bangkok International Banking Facilities recently launched by Thailand has already created similar problems for the Thai central bank in its efforts to control domestic liquidity and inflationary pressures, although the situation has remained well within control.

Two related issues have recently been raised in this context. First, there appears to be an increasing degree of currency substitution occurring, whereby the debts and savings in local currency in some developing countries are being replaced by debts and savings in foreign currency. This reduces the control of a Government on its own money supply and the effectiveness of any changes it tries to induce. Second, there are questions being raised as to how much of the expanded activity on stock markets actually relates to new physical investment, rather than a churning of funds or a refinancing of existing debts. While this may be a temporary phenomena as enterprises and investors adapt to their new freedom and expanded menu of opportunities, it does call into question the impact of financial reforms on the performance of the real economy and the need to encourage direct foreign investment when possible.

Thus, financial sector as well as trade sector reforms are forcing countries to learn how to function in a global system. Their degrees of freedom to make independent policy decisions are becoming severely restricted as both domestic and foreign concerns will react quickly to the signals given.[35] Moreover, changing circumstances or policies in the major economies of the world can create large reactions in small economies irrespective of their own policies and position. The implications of this globalization for Asian economies are not yet fully understood and deserve further attention. In particular, countries of the region should strengthen mechanisms for sharing experiences for the benefit of all.

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32 "US interest rate hike sends SET index into tailspin for 70-point loss", *Bangkok Post* (24 November 1994).

33 See the discussion on this issue in Min Tang, *Recent Development on Capital Flows to the ASEAN and Pacific Developing Countries* (Manila, Asian Development Bank, 1994), pp. 26-30.

34 Bank Negara Malaysia, *Annual Report 1993* (Kuala Lumpur, 1994), p. 38.

35 "In this new battleground for savings, market players will become a new class of stateless legislators. With the power of the purse, they will check governments' ability to tax, spend, borrow or depreciate their debts through inflation" in "Borderless finance: fuel for growth", *Business Week* (special edition, 1994).

V. SOCIAL SECURITY

Despite commendable economic progress, the ESCAP region remains beset with many social problems. One of these is persistent poverty. Sustained economic growth and various types of policy interventions have reduced the incidence of poverty quite considerably in some countries of the region. Yet, large proportions of the population of many countries, amounting to very large absolute numbers of people, remain poor. Indeed three fourths of the world's poor people live in the region. Poverty manifests itself in many forms of deprivation which become permanent features in the life of those who are its victims. Inadequate food and nutrition, and health, education, housing and sanitation facilities are the principal forms of deprivation.

While pervasive deprivation has been the result of slow development or inequitable distribution of its benefits, it is also generated or worsened by vulnerability to a series of causes, some of which are incidental to modern socio-economic processes. Social security as an objective and a policy tool has been implemented in the developing countries of the region alongside other measures to mitigate the adverse impact of those vulnerabilities.

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

Social insurance is a publicly sponsored and compulsory insurance system under the cover of law, with defined benefits financed by contributions from employers, and sometimes from employees and government subsidies. In some instances, laws may, however, make enabling rather than compulsory provisions for people to join insurance schemes voluntarily. Non-employee populations can also join such a system by paying contributions. The principle of social insurance is grounded in spreading risks and sharing financial costs on a non-profit basis. Contributions are accumulated in special funds, out of which benefits are paid to those meeting the qualifying conditions. Benefits flow in the form of pensions or other compensations depending on the nature of the contingencies covered. With its many variations in form, social insurance can partly or wholly cover most of the contingencies specified above with benefit entitlements to those who are insured.

Social assistance is a system of social security, which is financed from general revenue rather than from individual contributions. Such assistance can cover a number of the above contingencies. Benefits are often adjusted according to a person's means, designed to bring the total income of a person or a family up to a certain minimum level. However, the State can choose to finance from general revenue social security benefits without applying a means test, such as pensions to the aged, the invalid, the orphaned and the widowed as well as free medical care for all.

Another social security mechanism, employer liability, was originally directed towards the risk of employment injury, placing legal responsibility on the employer to provide compensation and medical care in respect of employment injuries either directly or under insurance policies. Subsequently, the scope and extent of employer liability have been extended to cover such contingencies as sickness and maternity including provisions for paid sick and maternity leave, and medical care for the employees and their family members. Employers are also obliged under labour laws to make severance or redundancy payments to workers on dismissal.

Many countries have legislation supporting the establishment of provident funds as a means of compulsory saving with contributions usually paid by both the employers and employees. A central fund is thus created with contributions credited to separate accounts for each individual. The accumulated credit, with interest added periodically, is paid out to the individual in the event of old age, invalidity, or in case of death to the survivors. Instead of a lump-sum cash withdrawal, provident fund accumulation can be also converted into an annuity or superannuation upon retirement.

Social security as described above has grown along with social services generally provided by the State. Such social services include a wide range of provisions, such as for health services and preventive health care, accident prevention and rehabilitation, special facilities for the disabled and old people, child welfare, and family planning, to name a few.

The provision of social services by the State has proceeded parallel to development of social security in its conventional sense, which may be necessary but not sufficient to meet the needs of the developing countries, where permanent deprivation and vulnerability are integral to the lives of many. Social security in the developing countries, therefore, needs to be understood broadly. In the long run, it has to be mediated through the growth process as well as active public, policies and actions to facilitate wide participation of the population in the process of economic expansion particularly through the promotion of skills, education and employment.[1] In this sense the whole range of economic and social policies and measures as well as support systems available within family and community networks including non-governmental organizations (NGOs), religious charities and philanthropic foundations, all constitute legitimate forms of social protection (see table V.1).

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

This chapter brings together the information on social security in the region under state legislated provisions. The discussions are organized around the nine contingencies identified in ILO Conventions for the conferment of benefits.

OLD AGE, INVALIDITY, AND SURVIVORS

Old age may officially start at the age of retirement which, in most cases, varies from 55 to 60 years in countries in this region. With retirement, regular earnings cease and, therefore, provisions need to be made in advance for such a contingency when it arises. A person may become wholly or partially invalid, either permanently or for a temporary duration, thus losing the capacity to engage in any gainful activity, even before retirement. The contingency of such invalidity, permanent or temporary, which any sickness benefit may not cover, has to be met. Death may occur prematurely, leaving dependent family members without any means of support. Social security provisions are, therefore, necessary for all these contingencies.

By the year 2025, 57 per cent of the world's 1,181 million elderly aged 60 and above will live in the ESCAP region.[2] Their numbers in the region's developing countries will rise from 246 million in 1995 to 627 million in 2025, an increase of 2.5 times. Not only are there more elderly, the elderly population itself is aging. Those aged 75 and over are projected to increase from 55 million to 146 million or by 2.7 times in the developing ESCAP region during the same 30-year period. These people have already been born; thus, no policy intervention can change their absolute numbers. The demographic transformation underway in the region suggests that in the coming decades the region's population will not only comprise more elderly, but more of them will be women owing to differences in life expectancy between

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1 Jean Drèze and Amartya Sen, "Public action for social security: foundations and strategy" and Robin Burgess and Nicholas Stern, "Social security in developing countries: what, why, who, and how" in *Social Security in Developing Countries*, edited by Ehtisham Ahmad, Jean Drèze, John Hills and Amartya Sen (Oxford, Clarendon Press, 1991), p. 24.

2 United Nations, *The Sex and Age Distribution of the World Populations: The 1994 Revision* (United Nations publication, Sales No. E.95.XIII.X).

Table V.1. Major features of social protection

Social protection needs	*Mechanisms for the fulfilment of social protection needs*	
	Formal	*Non-formal*
Adequate and stable income from economic activities	Macroeconomic policies to promote economic growth, employment and self-employment	
a: Protection and replacement of earnings from economic activity (including individual and family enterprises, farms)	i) State-supported poverty alleviation programmes, such as, employment, rural development and income generation schemes ii) Tenancy reforms, livelihood schemes, credit schemes for production, income generation and self-employment initatives iii) Education and training programmes iv) Unemployment insurance v) Social assistance by the State	i) Resource sharing among family, kinship and community networks ii) Community sharing of resources such as land, forest, water and fishing areas iii) Work exchanges among family, kinship and community networks iv) Intergenerational education and training for family enterprises in agricultural and commercial activities v) Apprenticeship training while earning vi) Employment with in-kind earnings vii) Voluntary and religious association-sponsored schemes for economic activity viii) Seasonal migration to earn income ix) Credit from money lenders
b: Replacement of household earnings for an earner with disability due to injury, sickness, death, maternity, old age, temporary or permanent incapacity for economic activity or unemployment	i) Accident and disability insurance ii) Sickness and maternity insurance iii) Old age and invalidity insurance iv) Death insurance with dependent survivors benefits and funeral benefits v) Social assistance by the State vi) Savings, assets and investments	i) Support among family, kinship, community, voluntary, and religious organizations (often using social insurance principles) ii) Sharing of food and other resources iii) Work, resource, and harvest exchange iv) Revolving savings and credit associations v) Death and mutual aid or welfare societies
c: Loss of resources or faculties necessary for earning income from economic activity (due to fire, theft, accident, riots, disaster etc.)	i) Emergency relief by the State ii) Insurance for damage to facilities, loss and damage of work instruments iii) Livestock insurance (loss, medical) iv) Crop insurance (damage or loss) v) Invalidity and disability insurance with benefits for dependent family members	i) Relief efforts of community networks, voluntary and religious organizations ii) Family and kinship support obligations (often using social insurance principles) iii) Resource, work and harvest sharing iv) Revolving savings and credit associations v) Credit from money lenders
Medical and other care during disability, sickness, maternity, invalidity, and old age	i) Public health facilities and services ii) Rehabilitation with state programmes iii) Insurance for care and hospitalization iv) Private and public housing and care in retirement homes, sanitoriums, orphanages	i) Traditional medicines and practices ii) Voluntary and self-help schemes iii) Sharing care within family and community networks (children, disabled, elderly, and persons with serious or long-term illnesses)
Food and nutrition	i) Public distribution of food schemes ii) Food-for-work schemes iii) Food-for-education schemes iv) Social assistance by the State as food stamps, income transfers, or in-kind benefits v) Food and nutrition schemes for infants, children and their mothers vi) Maintenance of national food stocks vii) Emergency and disaster relief	i) Household food production and storage ii) Sharing among family and kinship networks, community and religious organizations iii) Harvest sharing and religious festivals iv) Consumer cooperatives v) Credit and thrift societies vi) Apprenticeship and self-help schemes

Sources: Compiled by the ESCAP secretariat from various national and international sources.

Table V.2. Financing techniques for old age, invalidity and survivors benefits

Provident fund	*Social insurance*	*Social assistance*
Bangladesh	Afghanistan	Australia
Fiji	Armenia	Hong Kong
India	Azerbaijan	Indonesia
Indonesia	China	India
Kiribati	India	Kazakhstan
Malaysia	Indonesia	Kyrgyzstan
Maldives	Iran (Islamic Republic of)	Malaysia
Nepal	Japan	New Zealand
Papua New Guinea	Kazakhstan	Republic of Korea
Samoa	Kyrgyzstan	Sri Lanka
Singapore	Malaysia	
Solomon Islands	Mongolia	
Sri Lanka	Myanmar	
Thailand	Pakistan	
Vanuatu	Philippines	
	Republic of Korea	
	Sri Lanka	
	Tajikistan	
	Thailand	
	Turkmenistan	
	Uzbekistan	
	Viet Nam	

Sources: N.P. Banna, "Old-age protection systems" (ISSA/ASIA/RTC/KL/IV: Appendix) (Geneva, International Social Security Association, 2 May 1991); P. Singh, *Social Security in Asia and Pacific: A Comparative Study* (New Delhi, Friedrich Ebert Stiftung, 1992); U.S. Department of Health and Human Services, *Social Security Programmes Throughout the World – 1991 and 1993* (Washington, DC, Government Printing Office, 1992 and 1994); other national, international and United Nations agency sources.

women and men. These women are likely to be widowed.[3] Provision for old age security and against the risk of invalidity or death is thus emerging as a major concern in the region.

Social insurance, social assistance and provident funds are forms of financial provision for retirement, invalidity and survivor benefits (table V.2). Some of the countries use exclusively one or the other of these financing mechanisms. For example, Australia, Hong Kong and New Zealand provide only social assistance for these contingencies. Many of the developing countries depend on provident funds alone for retirement benefits. However, a large number of countries use elements of all three methods in different ways, and sometimes in combination, to provide for the three contingencies discussed here. Public employees in many countries are entitled to retirement pensions that may also include entitlements for survivors as well as compensation for contingencies such as invalidity. In some countries, compulsory savings in provident funds with contributions from the Government supplement such non-contributory pensions.

3 United Nations, *Compendium of Social Development Indicators in the ESCAP region* (ESCAP, Bangkok, 1993).

Social insurance

Coverage

Social insurance functions as a major form of financing retirement, invalidity and survivor benefits in many countries. Participation in social insurance schemes is usually limited to employees as opposed to the self-employed. It is frequently restricted further by the type of employment or the size and nature of the establishment in which employees serve or both (table V.3). In most cases, only employees in relatively large private sector establishments, designated by the number employed, are covered. In many cases, earning limits or age limits of employees are also used as criteria for coverage. In most cases, public employees' pensions are part of the guaranteed perks of employment without any further contributions from the employees, the Government undertaking the liability as a condition of employment. However, public sector employees, where they do not receive non-contributory pensions, and where they come under a compulsory social insurance system as in the Philippines, have more general coverage.

Coverage under social insurance for the above reasons is rather limited in most countries of the

Table V.3. Main features of social insurance schemes for old age, invalidity and survivor benefits

	Coverage	*Benefits*	*Contributions* [a]		
	as defined in legislation, including specified exclusions and exemptions	*see codes in notes*	*Employee (% of earnings)*	*Employer (% of payroll)*	*Government (% of payroll)*
Afghanistan	Employees in private establishments, cooperatives, social organizations, joint enterprises and government	rp,ip	3 *additional by rank or grade*	none	3 *as subsidy*
Armenia[b] **Azerbaijan**[b] **Tajikistan**[b]	Employees and members of state co-operatives and farms	rp,ip,sp	1	12.1 to 26 *by industry*	50 per cent of costs
			also finances sickness, maternity, work injury benefits and family allowances		
China	a) Urban employees in state-run, collectively-owned, joint-venture establishments:	rp + supplement, ip,sc,dc		subsidy plus	
	i) Permanent employees		none	18	subsidies
	ii) Contract employees		3	15	*as needed*
	b) Employees in party organizations, and of government in culture, education, science		none	*government*	entire cost
India	a) Gratuity: establishments with 10+ employees including factories, mines and plantations *Exclusions: employees earning Rs 2,500 or more a month*	a) rc,ic,s	none	4 *average*	none
	b) Provident Fund members in establishments at least 3 years old with 20+ employees in 177 industries: i) Family Pension Fund	b.i) rc,sp,dc	1.17	1.17	1.17 plus administration
			diverted from provident fund		
	ii) Deposit-linked Insurance *Exclusions: employees earning Rs.3,500 or more a month and those employees previously identified as exluded from membership* *Exemptions: members of approved private plans*	b.ii) sc	none	0.5 + 0.1 *for administration*	0.25
	c) Group insurance: landless agricultural workers	c) sc	none	none	entire cost
Indonesia	Members of provident funds in the private sector:				
	a) Death insurance	sc,dc	none	0.5	none
	b) Retirement insurance (endowment insurance)	rc	1	1.5	none
	Government employees	rp,sp	4.75	*government*	state budget
Iran (Islamic Republic of)	Employees in specific occupations and geographical areas	rp,ip,sp,d	7	20	3
			also finances sickness, maternity, work injury, medical care		
	Seasonal employees	rp,ip,sp,dc	9	20	3
	Self-employed, voluntary within earnings limits	rp,ip,sp,dc			
	Public employees	rp,ip,sp,dc	none	*government*	8.5
Japan	a) Employees of firms in industry and commerce (maximum/minimum: 530,000/92,000 yen)	rp,ip,sp	7.25/7.225 male/female	matching	administration
	b) Contract employees in industry and commerce	rp,ip,sp	5.65/5.625	matching	administration
	c) Miners and seamen	rp,ip,sp	8.15	8.15	administration
	d) Schemes for farmers, private school teachers, and employees in agricultural, forestry, fishery co-operatives, and public employees	rp,ip,sp	..	..	..
	e) All residents aged 20-59 years, voluntary for 60-64 years, and for citizens residing abroad aged 20-64 years (universal)	rp,ip,sp	10,500 yen per month	c	33.33 of costs plus administration
Kazakhstan	Employees residing in the country, including foreign citizens and those without citizenship	rp,ip,sp	1	37	subsidies *as needed*
			also finances sickness, maternity, work injury, family allowances		

(Continued on next page)

Table V.3 *(continued)*

	Coverage	Benefits	Contributions[a]		
	as defined in legislation, including specified exclusions and exemptions	*see codes in notes*	*Employee (% of earnings)*	*Employer (% of payroll)*	*Government (% of payroll)*
Kyrgyzstan	Employees and members of cooperatives	rp,ip,sp	1	31.8	subsidies
	State and collective farms	rp,ip,sp	1	22.4	*as needed*
			also finances sickness, maternity, work injury, family allowances		
Malaysia	Invalidity scheme: employees, aborigines, fishermen, agricultural workers in paddy fields Voluntary for those earning M$ 2,000 or more a month	ip,sp,dc	0.5	0.5	none
	Exclusions: casual employees and domestics				
	Public employees (Government Pension Scheme)	rp	none	*government*	entire cost
Mongolia	Employees, voluntary for self-employed	rp,ip,sp	none	13.5	50 per cent of costs
			also finances all other benefits		
Myanmar	Permanent employees in cooperatives of public and private sectors	rp	..	..	..
	Permanent employees of the Government	rp	none	*government*	entire cost
Pakistan	Employees in firms with 10+ employees, managers, administrators earning up to PRs 3,000 a month	rp,ip,sp	none	5	5
	Exclusions: family labour and the self-employed				
	Schemes for public employees, armed forces, police, statutory bodies, local authorities, bank, and railway employees	rp,ip,sp	5	*government*	5
Philippines	Government employees	rp,ip,sp,dc	8.5	*government*	9.5
	Employees in the private sector, seafaraers, self-employed earning P 1,800 or more a month	rp,ip,sp,dc	3.3	4.7	covers any deficits
			also finances sickness benefits		
	Self-employed farmers, fishermen earning P 1,500 or more a month (maximum: P 6,000 a month)	rp,ip,sp,dc	8 self-employed	none	
Republic of Korea	Citizens and residents aged 18-59 employed in firms with 5+ employees	rp,ip,sp,ad	2	2	administration
	Exemptions: special schemes for private school teachers, military and public employees				
Sri Lanka	Farmers and fishermen engaged in small-scale and subsistence activities, aged 18-59	rp	increases with age		matching
Thailand	Establishments with 10+ employees	ic,dc	1.5	1.5	1.5
	Voluntary for the self-employed	ic,dc	3		1.5
	Exemptions: Public employees and members of private plans offered by employers with comparable benefits		*also finances sickness and maternity benefits*		
Turkmenistan	Employees in enterprises	rp,ip,sp	1	37	subsidies
	Members of co-operatives, and state farms.	rp,ip,sp	1	26	*as needed*
			also finances sickness, maternity, work injury, family allowances		
Uzbekistan	Employees, and members of state cooperatives and farms	rp,ip,sp	1	37	*as employer*
			also finances sickness, maternity, work injury, family allowances		
Viet Nam	Employees in state sector	rp,rc,ip,ic,sc	none	3	*as employer*

(Continued on next page)

Table V.3 *(continued)*

Sources: P. Singh, *Social Security in Asia and Pacific: A Compartive Study* (New Delhi, Friedrich Ebert Stiftung, 1992); U.S. Department of Health and Human Services, *Social Security Programmes Throughout the World – 1991 and 1993* (Washington, DC, Government Printing Office, 1992 and 1994); other national, international and United Nations agency sources; and "Uzbekistan" and "Turkmenistan", *IMF Economic Reviews*, No.4, 1994, pp. 81-85 and No.3, 1994, pp. 94-96; International Labour Office, "Report to the Government of the People's Republic of China on social security reform" (Geneva, 1993); P. Singh, "National strategies for the extension of social security to the entire population: the Malaysian experience" (ISSA/ASIA/RM/92/2 – Malaysia) (Manila, International Social Security Association, 1992); and International Labour Office, "Report to the Government on social protection development: Mongolia" (MON/91/M02/NET/01) (Geneva, 1993).

Notes: rp = retirement pension; ip = invalidity pension; sp = survivors pension; rc = cash in lump sum on retirement; ic = cash in lump sum for invalidity; sc = cash in lump sum for survivors in case of death; dc = cash in lump sum upon death, e.g. funeral grant; annuity = insurance providing regular annual income until death; ad = annuity for dependents (child, parent, spouse).

[a] Contributions may also finance other benefits as indicated. The rate of contribution is a statutory requirement.
[b] This system was adopted in 1990, but later information is not available.
[c] Employer contributions to the National Pension Scheme in Japan are included in rates for employment-related schemes.

region. Some of the countries which have advanced social insurance systems, and do not use at all or make limited use of the other financing mechanisms, have a better coverage in terms of the number and proportion of the population under their social insurance schemes. Among them are China, the Islamic Republic of Iran, the Philippines, the Republic of Korea and most of the former centrally-planned economies in transition.

In China, employees in state-run, collectively owned and joint enterprise establishments in urban areas, employees of the Government and party organizations, and employees of cultural, educational and scientific institutions are covered by a labour insurance system.[4] About 90 per cent of urban employees are covered by insurance for retirement, invalidity and survivor benefits. In the Islamic Republic of Iran, social insurance run by the Social Security Organization provides compulsory coverage for a wide range and category of employees, and offers voluntary coverage to the self-employed.

In the Philippines, the Government Service Insurance System compulsorily covers all permanent employees.[5] Under a separate Social Security System all employers and employees in the private sector engaged in trade, business, industry – undertakings of any kind using the services of another person – are required to join compulsorily. Voluntary coverage was extended to the self-employed farmers, fishermen and home workers in 1992. Also in 1992, under the Women in Development and Nation Building Act, coverage was extended under both schemes to married women who are full-time home managers upon consent of the employed husband from whose salary contributions are deducted. The Philippines is thus among the countries with very extensive social insurance coverage, extending to 53 per cent of its economically active population.

In the Republic of Korea, the Retirement Payment Fund financed by employers in establishments with five or more employees covered retirement benefits.[6] Recently the National Pension Scheme has been introduced as a compulsory requirement for those employed in industrial and commercial units with five or more employees, with which the existing Retirement Payment Fund will be gradually merged. The self-employed in both rural and urban areas can join the pension schemes on a voluntary basis. Pensions for civil servants, military personnel and private school teachers are provided through separate schemes. The Republic of Korea, thus, has a broad coverage under social insurance, extending to about one third of its economically active population. Social insurance coverage for old-age, invalidity and survivor benefits is universal in Japan (see box V.1.) and also in most of the former centrally-planned economies in Central Asia.

4 International Labour Office, "Report to the Government of the People's Republic of China on social security reform" (Geneva, 1993).

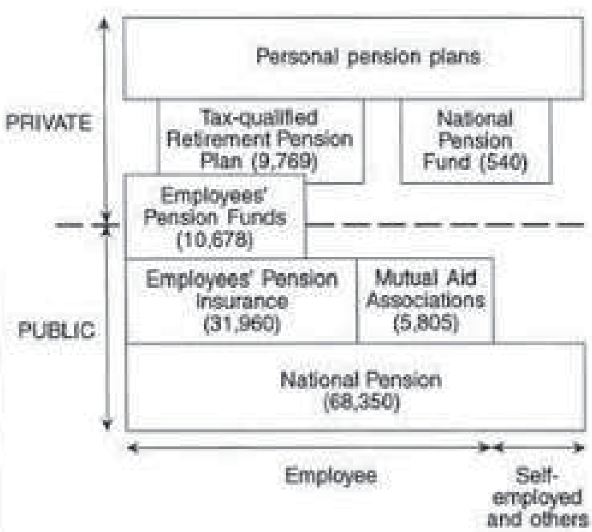
5 H.B. Inductivo and F.E. Villaruz, "National strategies for the extension of social security to the entire population: the Philippines" (ISSA/ASIA/RM/92/2 – the Philippines) (Manila, International Social Security Association, 1992).

6 Un-Hang Shin and Jae-Sung Min, "Introduction and extension of the National Pension Scheme: The Korean experience" (ISSA/ASIA/RM/92/2 – Korea) (Manila, International Social Security Association, 1992).

Box V.1. Japan's pension system: gearing to the needs of an aging society

The pension system in Japan has achieved universal coverage. It has evolved through a long historical process dating back to 1884. Only a few public schemes for government employees organized as mutual aid associations, existed up to the end of the Second World War. Public schemes, covering the private sector were renamed Employees' Pension Insurance in 1944, with subsequent expansion in coverage to most employees in the private sector. Separate mutual aid associations cover employees of local government bodies and public enterprises; private school teachers; and the employees of agricultural, fishery and forestry institutions. In 1961, the National Pension system was introduced covering the self-employed, the farmers and others not covered by existing schemes. The pension system thus comprised several coexisting subsystems in order to achieve universal coverage (see figure below).

Pension schemes in Japan



Sources: Yasuyuki Fuchita, "Savings promotion and the pension fund: Historical review of the Japanese case" in *Generating a National Savings Movement*, edited by Al'Alim Ibrahim, Proceedings of the First Malaysian National Savings Conference, Kuala Lumpur, 8-10 July 1993, p. 297.

Notes: Numbers in parenthesis represent the number of participants in thousands.

Since their simultaneous establishment as corporate pension plans in the 1960s, Tax-qualified Retirement Pension Plans and the Employees' Pension Funds have expanded along with personal pension plans involving the individual purchase of plans from insurance companies and banks. The Tax-qualified Retirement Pension Plan is independently designed at a corporation's discretion in accordance with certain standards set by the Government. The Employees' Pension Fund is organized as an independent fund established by a corporation on behalf of its employees. These funds can be linked to the Employees' Pension Insurance and pay part of its benefits, together with its own added benefits. Corporate pension plans are thus designed as private pension plans with tax incentives to offer another overlapping tier of employment-related benefits in addition to the public pensions.[a]

Since these various pension plans were established, Japan has been experiencing rapid socio-economic changes, calling for reform of its public pension system. For example, the National Pension system established in 1961 came under financial pressure with a decline in contributions as the self-employed were gradually absorbed as employees. The other basic trend has been a rapid increase in the size and proportion of the elderly population and a reduction in the family size, both having significant implications for the pension system.

In 1984, the Government initiated reform of the public pension system, to be completed by 1995, aiming at a gradual integration of these various subsystems. The objectives are to secure fairness in respect of both pension benefits and cost sharing among all the pension schemes and to create a system capable of responding to the changing industrial and employment structure as well as to an increasingly elderly society.[b] As a first step towards integration, a Basic Pension benefit was introduced, effective April 1986, merging the first tier benefits

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[a] Yasuyuki Fuchita, "Savings promotion and the pension fund: historical review of the Japanese case" in *Generating a National Savings Movement*, edited by Al'Alim Ibrahim, Proceedings of the First Malaysian National Savings Conference, Kuala Lumpur, 8-10 July 1993.

[b] Ministry of Health and Welfare, *Annual Report on Health and Welfare 1992-1993* (March 1994), p. 198.

of the existing schemes,[c] and offering a uniform Basic Pension to anyone between the ages of 20 and 60 who has an address in Japan.[d] Coverage under the National Pension is automatic for those who are covered by the Employees' Pension Insurance and Mutual Aid Pension systems.

In 1989, the National Pension Fund was established to supplement the Basic Pension for the self-employed and others. Under this plan, pension funds can be constituted on a residential basis, such as in prefectures, with a membership of at least 1,000; or they can be organized nationally by people sharing the same occupation with the minimum required membership of 3,000. By the end of 1992, such funds were operating in each of the prefectures in Japan; and 23 occupational funds had been established.

As a result, Japan has had a very successful pension system. According to a 1991 survey, 96.9 per cent of families with an elderly member aged 65 or above receive pension benefits; and pension benefits, on the average, constituted almost 55 per cent of an elderly person's family income. Thus, public pension schemes spread widely in Japan and became an essential pillar in sustaining the living standards of the elderly.[e]

As the elderly population is projected to increase their share of the population from its current 14 to 25 per cent in 2020, and the number of elderly is projected to double during these 25 years,[f] one basic objective of the ongoing process of reform is the financial sustainability of the public pension system.[g] While requiring the maintenance of appropriate benefit levels, sustainability also requires moderation of the contribution burden that the succeeding generations will be able to afford.[h]

At the present, the public pension system is financed by contributions and government subsidies. Government subsidizes one third of benefit expenditures for the Employees' Pension Insurance and the mutual aid associations, the other two thirds being contributed by employers and employees. The Basic Pension is equally financed by contributions from the Employees' Pension Insurance and the mutual aid associations, with the Government contributing the remaining one third of total expenditures. In addition, interest and income earned on the large Pension Reserve Fund augment these contributions considerably.[i] By this process, pension costs in Japan have been kept relatively low to employees compared with those of other countries for equivalent levels of pension benefits. The reformed National Pension system, while removing some of the inequitable features of the old system, has been financially strengthened by extending its coverage to all through a variety of public options for setting up funds. During recent years, there has been a rapid expansion in corporate and personal pension plans as private supplements to these public provisions. Although the populations of most developing countries are not aging as rapidly as Japan, several of them in the region will face similar situations in different degrees, for which they need to prepare in advance.

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c The existing schemes offered two-tiered benefits, one, a flat amount and the other, proportional to earnings.

d Susumu Kaneko, "Pension operation and services for the insured and beneficiaries in Japan: the present state and future objectives" (ISSA/ASIA/RM/92/3-Japan), paper presented for the International Social Security Association Regional Meeting for Asia and the Pacific on the Extension of Social Security Protection to the Entire Population, Manila, 8-10 June 1992, p. 5.

e Ministry of Health and Welfare, op. cit., p. 196.

f Katsuyoshi Iwabuchi, "Social security today and tomorrow" in *Economic Eye*, vol. 15, no.2 (Keizai Koho Center, Japan Institute for Social and Economic Affairs, 1994), p. 3.

g A March 1994 report of the Ministry of Health and Welfare had indicated that the cost of Japan's social welfare programmes will entail a burden of about 51 per cent of national income in 2025, even in the best case scenario that may steer a course mid-way between the low welfare and high welfare models of other developed countries. Iwabuchi, ibid.

h Based on a 1989 acturial calculation (being revised on a 1994 re-evaluation), it is estimated that the contribution rates for the Employees' Pension Insurance will go up from 14.5 per cent of earnings in January 1991 to 31.5 per cent in 2020 if the pensionable age remains at 60, to to 26.1 per cent if the pensionable age is raised to 65 (one option being considered to keep people working and contrubuting longer, while moderating demand for payments). Kaneko, op. cit.

i Ministry of Health, op. cit., p. 201.

Benefits

The benefits of social insurance may be limited to retirement pensions or extended to invalidity and survivors. The qualifying conditions vary as greatly as do benefits or entitlements. Their full details are too complex to describe unless a case-by-case approach is adopted. In some instances, lump-sum cash benefits rather than pensions are paid, particularly for invalidity and for survivors. Sometimes insurance and provident fund schemes are linked to provide cash compensation for survivors, for example, and pensions for retirement.

Besides a lifetime pension from a scheme currently being implemented throughout rural China, cash payment to the family is guaranteed for 10 years if death occurs before the age of 70. Some schemes also provide cash benefits at death, such as for funerals in the Philippines. Schemes supplementing provident funds furnish cash benefits rather than pensions. The Deposit-linked Insurance associated with the Employees' Provident Fund in India is one example. The death and retirement insurance for provident fund members in the private sector in Indonesia also provides lump-sum cash benefits rather than pensions. In Malaysia pensions are provided under a separate insurance scheme for invalidity only while cash benefits are provided for all three contingencies under the national provident fund.

Financing

Old-age, invalidity and survivors benefits are financed by contributions from employers, employees and the Government with wide variations in practice. As noted above, the earliest form of retirement benefit in the ESCAP region is the provision by Governments of pensions to civil servants. Many of them are financed solely by Governments from general revenues as non-contributory schemes, with their continuation being decided annually by parliaments, while others are financed jointly by Governments with compulsory contributions from employees. For example, pension schemes for the central government employees and railway workers are entirely financed by the Government of India. Pension schemes for all public employees are similarly financed in Bangladesh. The Civil Servant Pension Organization in the Islamic Republic of Iran is entirely financed by the Government with a contribution of 8.5 per cent of payroll. However, in Indonesia civil servants contribute to an endowment insurance scheme with a pension plan that includes no contribution from the Government.[7]

The rates of contribution to be paid to social insurance schemes by the parties involved may vary depending on many factors. In the Philippines, for example, employees in the private sector pay a lower rate than employers, with the Government responsible for any deficits. Public employees finance insurance jointly with the Government, the latter paying a slightly higher rate of contribution. The 1990 legislation adopted in Thailand establishes equal contributions from employees, employers and the Government. In the Republic of Korea, employees make no contribution to the Retirement Payment Fund that is currently paying pensions; however, they share the financing with employers for the National Pension Scheme that is being implemented. The self-employed in the Republic of Korea are voluntarily covered at a separate rate of contribution that is higher than for either the employers or employees, but less than their combined rate. In the Philippines, the self-employed pay the combined rate of employers and employees for voluntary coverage. The self-employed in Armenia, Azerbaijan and Tajikistan, however, are responsible for paying at the rate which employers pay.

In the Islamic Republic of Iran, employers are the major contributors to social insurance for employees. Seasonal employees are covered at a slightly higher rate of payment than regular employees. The Government makes a standard contribution while also paying for the protection of the first five employees in small industrial and technical workshops who otherwise would be excluded. The contributions to social insurance also cover other contingencies such as employment injury, medical care and sickness and maternity. Among the economies in transition, in Kazakhstan, Kyrgyzstan, Turkmenistan and Uzbekistan, contributions from employers ranging between 26 and 37 per cent of payroll and from employees, set at 1 per cent of earnings, finance the benefits for retirement, invalidity, and survivors as well as for sickness,

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7 S. Kertonegoro, "Investment of pension and provident fund reserves" (ISSA/ASIA/RC/91/1) (Jakarta, International Social Security Association, September 1991), p. 8.

maternity, employment injury and family allowances. The Government contributes as employer and provides subsidies as needed in other cases.

With the 1986 introduction of contract labour arrangements in state-owned enterprises in China, contract employees are now required to contribute at the rate of not more than 3 per cent of earnings. The contribution rates of employers vary according to differences in the retirement load of individual enterprises and in benefits offered in kind (such as housing, food, and a variety of services). Farmers in some parts of China have a scheme with shared contributions from individuals (80 per cent) and collective funds or enterprise profits (20 per cent). The Five Guarantees Scheme for food, clothing, housing, medical care and burial that caters to the needs of the elderly in rural China is being rationalized to shift the responsibility of financing it to collectives of brigades or cooperatives.

Pending implementation of the Social Security Act of 1990 in respect of its retirement benefits later this decade, Thailand provides, under social insurance, for lump-sum payments in case of invalidity and for surviving children. In Malaysia such partial coverage only for invalidity under insurance supplements the cash benefits for retirement, invalidity and survivors covered by the national provident fund. The invalidity scheme provides for pensions to employees in the private sector. This invalidity only insurance scheme of Malaysia is unique in the region with a complex set of rules of its own. Financed by equal contributions from employees and employers, benefits are payable for invalidity caused by any permanent physical or mental condition that is incurable and results in employees being unable to earn at least one third of previous earnings.[8] Benefits may be a lump-sum grant of the combined contributions if less than 24 contributions have been paid in the 40 months preceding the claim of invalidity; or, if the qualifications have been met, a pension until age 55 ranging from 50 to 65 per cent of the average monthly wage. A benefit introduced under the scheme in 1985 provides for a survivor pension for children until age 21, for widows until death or remarriage, and for other primary dependents subject to a dependency test. A funeral grant of M$ 1,000 is also paid to families of invalid pensioners or to those who qualify for a survivor pension.

Provisions of the current retirement pension system in the different republics of Central Asia find their origin in the 1956 old age pension system of the former Soviet Union. With independence, the republics established new schemes with reformed provisions. In these economies, benefits financed by contributions from state enterprises, cooperatives and state farms, which used to be viewed as components of wages and salaries, are no longer so regarded. The contributions collected from the production enterprises used to finance, in addition to retirement, invalidity and survivors benefits, employment injury, sickness, maternity and family allowances. The system in most of these countries is currently undergoing reform as the economies are moving towards market orientation and privatization of production systems. In some countries such as in Turkmenistan, the number of allowances from the pension and social insurance funds have been curtailed.

Besides schemes sponsored under legislation, several novel schemes have been devised in recent years to provide insurance for old age. A group of farmers in Haiphong Province of Viet Nam set up a scheme in 1987 with contributions levied in terms of rice, paid twice yearly shortly after harvest.[9] Contributions are voluntary and reduced with age, and a minimum of 15 years is required to qualify for a monthly pension. In the Farmer's Pension Scheme in Sri Lanka, initiated in 1987 on a voluntary basis, contributions increase with age, and are paid twice yearly according to the paddy crop season, with matching contributions from the Government. A similar scheme for people engaged in fishing was initiated in 1990, and a pilot scheme in the informal sector (traders, vendors, street hawkers etc.) starts in 1995.

Provident funds

Provident funds are a major instrument for providing old age security in Bangladesh, India, Maldives, Nepal and Sri Lanka in South Asia, in Indonesia, Malaysia, Singapore and Thailand in

8 P. Singh, "National strategies for the extension of social security to the entire population: the Malaysian experience" (ISSA/ASIA/RM/92/2 – Malaysia) (Manila, International Social Security Association, 1992).

9 International Labour Office, "Report to the Government on social protection reform: Viet Nam" (ILO/TAP/Viet Nam/R.19) (Geneva, 1994).

South-East Asia, and in Fiji, Kiribati, Samoa, and Vanuatu in the Pacific islands. The organizational structures for administering those funds and the categories of people entitled to benefit from them vary among countries.

Provident funds are organized by the Government for public employees in Bangladesh, India, Maldives, Nepal and Sri Lanka. They also cover employees on tea plantations in Bangladesh and India. In Nepal the Employees Provident Fund covers government employees and those of factories with ten or more employees, hotels and tourist firms. In Sri Lanka, the Public Service Provident Fund covers employees in the Government, and the Employees' Provident Fund covers regular and casual employees in the private, the public corporate and the cooperative sectors. Provident funds are established in selected industries with twenty or more employees in India, twenty-five or more employees in Papua New Guinea, and ten or more employees in Indonesia and Nepal. Provident funds facilities are available for nearly all employees in Fiji, Kiribati, Malaysia, Samoa, Singapore, Solomon Islands, Sri Lanka, Thailand and Vanuatu (see table V.4.)

In most countries, provident funds are compulsory savings schemes, limited mostly to employee populations especially in the public sector. Segments of the private sector are covered in many countries, but the self-employed and less organized employees in businesses and in personal services are excluded. Some countries, such as Malaysia, allow voluntary membership of the self-employed and those employed in domestic services to join its national provident fund scheme for all other employees. In contrast, the self-employed are specifically excluded from the Central Provident Fund in Singapore.[10] Membership in Singapore's Central Provident Fund is compulsory for all employees in the private sector, with exemptions for those covered by approved private plans offering equivalent protection. The Employees' Provident Fund in India is compulsory for large industrial establishments and currently covers more than 17 million employees in 192,000 establishments of 177 selected industries. Special provident funds exist for employees in coal mines, on tea plantations, and for seamen.

Provident fund benefits are generally in lump-sum cash withdrawals of contributions and accrued interest at the time of retirement. In response to criticisms that lump-sum benefits are insufficient to fulfil retirement needs, several funds provide the possibility of an annuity or superannuation upon retirement. Such provisions provide a regular annual income until death in India and Singapore, for example. In addition to the choice between cash withdrawal and an annuity, the provident fund in Fiji also finances a means-tested allowance for the needy elderly and widows. Survivors benefits from provident funds are generally limited to a lump-sum cash withdrawal of accrued savings and interest. However, several funds also provide an additional death or funeral grant to the surviving families.

Provident fund accumulations are generally based on joint employer-employee contributions. Governments contribute to provident funds for public employees in Bangladesh, India, Malaysia, Maldives, Singapore, Sri Lanka and Thailand. Governments do not make any contributions to provident funds for employees in the private sector. They are usually jointly financed with nearly equal contributions from employers and employees. Employer contribution rates are, however, higher than for employees in Malaysia, the Solomon Islands, Sri Lanka and Vanuatu.

Provident fund schemes can also take the features of insurance schemes. They are also used to finance individual investment plans or other needs by permitting earlier withdrawal in part or full, or in the form of loans or loan guarantees. The provident fund schemes of India, Malaysia and Singapore combine several such features. Singapore's Central Provident Fund has adapted to the changing needs of its members since it was established in 1955 as a simple compulsory savings scheme. Contributions, currently at an equal 20 per cent rate of earnings for both employers and employees, are deposited into three accounts: a Special Account reserved for old age; a Medisave Account for health care; and an Ordinary Account which can be converted into non-cash assets. Members can at any time invest up to 40 per cent of the savings of the Ordinary Account in property, equities or gold. Investment can be made in commercial property but the savings withdrawn must be returned when the property is sold. These savings can also be used for the purchase of Home Protection Insurance and Dependent Protection Insurance. The Medisave Account has provision for Medishield Insurance as voluntary coverage against the risks of catastropic illness. Members may deposit retirement savings in an

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10 L.L. Tien, "Social security in Singapore", pp. 216-288 in T.S. Sankaran and others, *Social Security in Developing Countries* (New Delhi, Har-Anand Publications, 1994), p. 219.

Table V.4. Main features of provident fund schemes

	Coverage	Benefits	Contributions[a]		
	as defined in legislation, including specified exclusions and exemptions	*see codes in notes*	*Employee (% of earnings)*	*Employer (% of payroll)*	*Government (% of payroll)*
Bangladesh	Public employees Employees on tea plantations	rc rc,ic,sc	.. 7	*government* 7	.. ..
Fiji	Employees, voluntary for non-employed aged 15-60 and by self-employed for death benefit *Exclusions: public employees, domestics, and military and police personnel* *Exempted: members of equivalent private plans*	rc (annuity,ic,dc sp, means-tested allowances for needy elderly and widows	7 F$ 7 for sp	7	none
India	Establishments with: a) at least 3 years old with 20+ employees in 177 industries; or b) 50+ employees in 98 industries *Exclusions: employees earning Rs 3,500 or more a month, members of schemes for coal mines and tea plantations and for seamen; and special system for public and railway employees* *Exemptions: members of approved private plans*	rc(annuity) ic,sc,dc rc(annuity) ic,sc,dc	8.33 10	8.33 10 plus 0.65 *for administration*	none none
Indonesia	Establishments with 10+ employees or a payroll of Rs 1 million or more a month, voluntary coverage available, and with gradual extension to smaller firms and casual employees Government employees	rc,ic,sc,dc rc,ic	2 3.25	3.7 *government*	none none
Kiribati	Employees aged 14 and older earning at least $A 10 a month *Exclusions: domestic servants, and employees earning less than $A 10 a month*	rc,ic,sc	5 $A 5 annual deduction for sc	5	none
Malaysia	Employees Voluntary for self-employed and domestics *Exclusions: casual employees, agricultural workers, employees earning M$ 1,000 or more a month, and employees covered by schemes for farmers, armed forces, and private school teachers*	rc,ic,sc	10	12	none
Maldives	Government employees and bonded graduates Government-owned and privately-operated bank and shipping companies	rp,ip rc,sc rc,sc	5 10 5	*government* 10 10	5 *owner* *owner*
Nepal	Permanent government employees, employees in corporate autonomous bodies, educational institutions; factories with 10+ employees, with extension to certain hotels and trekking firms	rc,sc,dc	10	10	none
Papua New Guinea	Establishments with 25+ employees *Exemptions: establishments growing or processing cocoa, copra, palm oil, rubber or tea; and members of scheme for public employees*	rc,ic,sc	5 voluntary increases to 10	7	none
Samoa	Employees	rp/rc,ip/ic,sp,dc	5	5	none
Singapore	Employees earning S$ 50 or more a month; public employees being phased-in as members *Exclusions: members of approved and equivalent private plans, and the self-employed*	rc (annuity) ic,sc	b *also finances retirement, medisave, properties, equities etc.*	b	none *as employer*

(Continued on next page)

Table V.4 *(continued)*

	Coverage	Benefits	Contributions[a]		
	as defined in legislation, including specified exclusions and exemptions	*see codes in notes*	*Employee (% of earnings)*	*Employer (% of payroll)*	*Government (% of payroll)*
Solomon Islands	Employees including domestic servants, aged 14+, earning SI$ 20, working 6+ days a month; voluntary for self-employed, unemployed aged 16-35. Separate scheme for public employees	rc,ic,sc,dc	5 SI$ 5 annually deducted for dc	7.5	none
Sri Lanka	Employees Public employees, including local government *Exemptions: family labour; approved private plans*	rc,ic,sc rc,ic,sc	8 6	12 *government*	none 9
Thailand	Employees in private sector, government enteprises and partnerships	rc	3 to 15	matching, *3 average*	none *as employer*
Vanuatu	Regular employees aged 14+ years; voluntary for members of religious organizations *Exclusions: employees earning below VT 3,000 a month or under subcontract; casual employees in agriculture or forestry; and approved private plans*	rc,ic,sc	3	6	none

Sources: International Labour Organization, "Technical note on social protection in the Republic of the Maldives" (Bangkok, Regional Office for Asia and Pacific, 1993); L.L. Tien, "Social security in Singapore", pp. 216-288 in T.S. Sankaran and others, *Social Security in Developing Countries* (New Delhi, Har-Anand Publications, 1994), p. 219; P. Singh. *Social Security in Asia and Pacific: A Comparative Study* (New Delhi, Friedrich Ebert Stiftung, 1992); U.S. Department of Health and Human Services, *Social Security Programmes Throughout the World – 1991 and 1993* (Washington, DC, Government Printing Office, 1992 and 1994); other national, international and United Nations agency sources.

Notes: rp = retirement pension; ip = invalidity pension; sp = survivors pension; rc = cash in lump sum on retirement; ic = cash in lump sum for invalidity; sc = cash in lump sum for survivors in case of death; dc = cash in lump sum upon death, e.g. funeral grant; annuity = insurance providing regular annual income until death.

[a] Contributions may also finance other benefits as indicated. The rate of contributions is a statutory requirement.

[b] Contribution rates vary with age (lower rate for aged 55+), with average of 20 per cent for employee and employer. Employee: 7 per cent of earnings, plus one third of earnings S$ 200-363; above S$ 363-1080, 22 per cent of earnings; S$ 1,080 or more, 18 per cent. Employer: 20 per cent on earnings S$ 50-1080. Public sector employees at same rate, non-pensionable officers at 60 per cent of private rate.

approved bank, or purchase a life annuity from a private insurance company. A compulsory mortgage insurance scheme helps members and their families settle outstanding loans on properties purchased from the Public Housing Scheme.

Membership in the Employees Provident Fund in Malaysia is voluntary for the self-employed and domestics but compulsory for all employees. Its members comprise 46 per cent of the economically active population.[11] Employers and employees are required to contribute at statutory rates based on earnings, but somewhat differentiated, with employee contributions set at a lower rate. Savings and earned dividends thus accumulated are retained in separate, individual accounts until retirement at age 55. In 1991, this national fund had 6.2 million members in 191,000 establishments. In case of death, survivors receive the money in the account, plus a benefit ranging from M$ 1,000 to M$ 30,000. Withdrawal and a similar benefit are allowed for permanent invalidity. Savings also may be withdrawn to construct or purchase a house.

Some of the schemes being introduced in India also incorporate a similar flexibility. In October 1992, a new voluntary provident fund plan was established in India to cover 5.5 million textile employees, limited to one member per household. Its financing is

[11] M.G. Asher, "Options for reforming the existing social security system in Malaysia" "paper presented at the Workshop on Social Security: "Social Security Towards 2020", Kuala Lumpur, 17-18 January 1994, p. 7.

equally shared by the central Government, the state Government and the employees. The accumulations from the combined contributions and a yearly interest of 11 per cent are payable upon termination due to age or dismissal, as a lump-sum cash payment. India is also considering a major change in its Family Pension Scheme for members of the Employees' Provident Fund by strengthening links between the provident fund and social insurance with the establishment of a new Pension Fund.[12] Financed from the diversion of contributions to the provident fund, the proposed insurance scheme will provide for comprenhensive benefits: a superannuation pension on retirement at the age of 58, a pension for the widowed, a permanent invalidity pension, a children's pension until the age of 25 years for up to two children, an orphan's pension payable on the death of both parents, and a bachelor/spinster pension to the nominee of the deceased for 20 years.

Current legislation under implementation and review in Indonesia and Thailand also aims at combining the features of provident funds and social insurance as components of comprehensive social security schemes. The 1992 legislation currently being implemented in Indonesia, introduces compulsory schemes for all employees in private and state enterprises, combining features of defined contributions and savings in provident funds yielding lump-sum cash payments with the defined benefit and pension features of social insurance.[13] Financing may maintain sole employer liability, or contributions may be shared by employers and employees.[14] With phased-in implementation of its 1990 legislation, Thailand is currently considering the combination of social insurance and provident funds to form two tiers of social protection.[15] Social insurance would form the first tier against poverty in old age, with pensions being set at a percentage of wages. The second tier involves a lump sum or an annuity from accumulated savings and investment incomes.

Social assistance

Social assistance pensions, financed from general revenues, are provided for old age, invalidity and survivors. Entitlement is based on specific criteria, often including a means test. In Australia, an Age Pension scheme supports about 76 per cent of the elderly including war veterans, using income and asset tests. With market reform Kazakhstan and Kyrgyzstan introduced social assistance as a supplement to social insurance. In other countries of the ESCAP region, such as in Indonesia, India, Malaysia, the Republic of Korea and Sri Lanka, social assistance is offered to the destitute and those living in absolute poverty. The conditions for social assistance entitlement vary among these countries.

Universal coverage is available in Australia, Hong Kong and New Zealand where all residents, subject to means tests for income and assets, may be eligible for monthly pensions. In Kazakhstan, a pension is available to economically inactive residents who are not eligible for payment from social insurance schemes which are employment-related. Surviving dependents who are ineligible for the usual survivor pension because of an insufficient length of employment under insurance cover, can also receive social assistance pensions. Invalidity pensions are also available to those residents who are not eligible for disability pensions offered under social insurance. In Kyrgyzstan also, pensions are available to citizens who are economically inactive, invalid or orphans. Most recipients are elderly women without employment-related coverage.

While few developing countries rely on social assistance as a major social security measure, they are increasingly adding or expanding it as part of their poverty alleviation strategy. As a supplement to provident funds and social insurance schemes, approximately 10 per cent of the elderly in Sri Lanka receive social assistance. States in India give a pension to about 9 per cent of the country's elderly. With few exceptions, these are reserved for the destitute, defined as a person without any source of income and without family or kinship network to support them. Destitute widows and deserted wives thus receive state pensions. Similarly, in Malaysia, those elderly who are without a residence or families to support them receive social assistance. The states of Malaysia also have special pension schemes for the poor. Some of the destitute elderly in Indonesia live in special homes where they participate in a system of income generation. Social assistance also enables poor

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12 B.N. Som, "Challenges to social security – our response" in T.S. Sankaran and others, *Social Security in Developing Countries* (New Delhi, Har-Anand Publications, 1994), pp. 338-351.

13 *Asian News Sheet*, vol. XXII, No.3, September 1993, p.9 (New Delhi, Regional Office for Asia and the Pacific, International Social Security Assiciation).

14 The Ministry of Finance is responsible for setting both contribution rates and benefit levels, linked with the retirement age.

15 R.P. Hagemann and others, "Thailand: developing the social security system" (International Monetary Fund, December 1993).

families to support their elderly in their own homes. The Livelihood Protection Scheme financed from general revenues in the Republic of Korea supported 13.7 per cent of the elderly in 1992, supplementing the coverage under the social insurance schemes.

EMPLOYMENT INJURY

As a result of advances in industrialization and increasing use of mechanical and chemical processes in production, there has been an increase in accidents, injury and diseases of various types in the course of work, which result in temporary or permanent disability, or even death. The rights of people to protection from and compensation for these contingencies are well recognized in international instruments as well as in national legislation. The benefit and compensation needs that arise from such contingencies may include medical care, rehabilitation, and income replacement during temporary or permanent disability, and for survivors in case of death.

Almost all Governments in the ESCAP region have adopted legislation to require social security schemes to be devised for those purposes. In the main, this body of legislation governs the relationship between employers and employees, especially in large enterprises. As a result, the burden of protection or compensation is mostly placed on the employers, which they can discharge either directly or through insurance arrangements. Those employed in smaller enterprises and as agricultural labourers are, however, frequently excluded along with the self-employed and family workers from any such arrangements. In many countries, Governments subsidize the costs of administration, health care, and other costs as a supplement to the obligations undertaken by employers.

Four different techniques for financing benefits for employment injury and occupational diseases are available in the countries of the region. These are: liability directly executed by the employer; insurance cover to be taken out by the employer with commercial carriers for the employees; social insurance with shared financing of premiums by groups of employers; and social insurance with joint financing by employers, employees and sometimes the Government (see table V.5). The benefits cover medical care (in kind and in cash), replacement income for temporary or permanent disability (lump-sum cash or periodic payments), cost of rehabilitation, and provision for survivors in case of death. Some employers maintain their own hospitals, clinics, and medical personnel to provide medical services to employees. Some social insurance organizations also maintain such establishments and services. Where they do not exist, payments are made for contracted services by the employers directly or through insurance arrangements. A significant contribution is made by Governments when public facilities and personnel are utilized to fulfil the purpose.

Table V.5. Financing techniques for employment injury benefits

Employer liability		*Social insurance*	
Direct liability	*Compulsory insurance*	*As employer liability*	*With joint financing*
Australia	Australia	China	Afghanistan
Bangladesh	Kiribati	Indonesia	Armenia
China	Nepal	Malaysia	Azerbaijan
Fiji	Papua New Guinea	Myanmar	India
Hong Kong	Republic of Korea	Pakistan	Iran (Islamic Republic of)
India	Samoa	Philippines	Japan
Indonesia	Singapore	Viet Nam	Kazakhstan
Iran (Islamic Republic of)	Solomon Islands		Kyrgyzstan
Malaysia	Thailand		Mongolia
Maldives			New Zealand
Myanmar			Tajikistan
Pakistan			Turkmenistan
Sri Lanka			Uzbekistan

Sources: See the source notes in table V.4.

The first of the four methods mentioned above involves employers assuming direct liability for paying compensation to employees. Governments in most countries take the responsibility as employers for their civilian and military employees. Under workmen's compensation laws covering various segments of the private sector, injured employees and their survivors make claims directly to the employer for payment. In many cases, the initial social security legislation introduced employer liability as the only form of protection for employment injury and related losses. Employers in the private sector still continue to assume such direct liability. It is still the only option available under workmen's compensation laws against employment injury in some countries.

Compulsory insurance with commercial carriers is also a form of employer liability used in the ESCAP region, whereby employers pay insurance premiums to finance benefits defined in legislation. While employers in some countries may choose direct liability or compulsory insurance, many countries offer employers compulsory insurance as the only choice for the purpose.

The majority of the countries in the ESCAP region, however, rely on social insurance to cover these contingencies for the private sector employees. The operation of social insurance usually involves the establishment of a public body to manage the pooled fund with procedures laid down for processing claims, determining awards and paying benefits. One salient feature of social insurance is the principle of sharing risks and pooling financial resources. When employers thus pool resources to share among themselves financial liability for premiums, they share risks and reduce costs relative to either direct liability or compulsory insurance. Countries in the ESCAP region are, therefore, increasingly introducing this mode of social insurance to replace or complement other methods.

The financing of social insurance is also jointly undertaken by employers and employees. When their contributions are supplemented by commitments from the Government, a tripartite relationship emerges to finance social insurance. Governments in many countries also share the costs of administration as well as other costs, such as for medical care.

Direct liability

Throughout the region, Governments assume liability for their employees concerning injuries and occupational diseases resulting from employment. In the private sector, employers maintain direct liability for compensation to defined employee groups. Workmen's compensation, introduced earlier in the century, continues to provide the legislative framework for the purpose in Bangladesh, India, Malaysia, Myanmar and Pakistan. Employers assume liability for lump-sum cash and periodical payments for varying periods as compensation for temporary and permanent disability. They are also responsible for some part of the income loss due to injury or death of an earner in the family. In some countries, employers assist survivors with funeral costs (table V.6).

While coverage is limited to a defined population, legislation also identifies specific exclusions. Bangladesh excludes clerical staff and employees earning above a specified monthly income. Pakistan excludes family labour, the self-employed and those whose monthly earnings are above a specified amount. The case of Hong Kong, which supplements the direct liability of employers with social assistance, appears unique, although many other countries offer public assistance for disability without regard to origin. In Indonesia, a complementary regulation on Occupational Accident Security was adopted in 1993 to require non-insurable employers – defined as business companies – to provide compensation directly to victims of natural disasters, orphans, and victims of accidents.[16]

Compulsory insurance

Compulsory insurance is an alternative in which employers meet their obligations by insuring their employees with commercial carriers by paying the premiums (see table V.7). Kiribati, Nepal, Papua New Guinea, Republic of Korea, Samoa, Singapore, Solomon Islands and Thailand offer this as the only option to employers. In Papua New Guinea and Samoa, all categories of employees are entitled to benefits from such insurance. It covers all manual labour in Singapore but excludes domestics, casual labour, family labour, the police and certain salaried employees. The Solomon Islands includes employees engaged on a part-time basis. Legislation in the Solomon Islands and Kiribati specifically excludes casual employees, while Kiribati also excludes employees with an annual income above a specified level.

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16 International Labour Office, "Report to the Government on social protection in Indonesia" (Geneva, 1993).

Table V.6. Direct liability for employment injury

	Coverage	Benefits
	as defined in legislation, including specified exclusions and exemptions	*see codes in notes*
Australia	Some employers permitted to act as self-insurers	dtp,dtc,sc,dc,r
Bangladesh	Railways and manufacturing units with 10+ employees; estates, docks and construction with 25+ employees; and factories with 50+ employees	dtp,dpp,dpc,sc
	Exclusions: clerical employees, employees earning Tk 500 or more a month	
China	Public employees; university students; and employees of scientific, cultural, and educational institutions, and of party organizations	mck,mcc sp,sc
Fiji	Employees and apprentices	dtp,dtc,sc,ds
	Exclusions: casual and family labour, military personnel, and some public employees, or other workers designated by the Government	
Hong Kong	Employees	dtp,dpc,ds,sc
	Social assistance: residents	dtp,dpp
India	Workmen's Compensation covers employees where social insurance scheme is not operative	dtc,dpc,
Indonesia	Employees in industrial, mining, transport, fishery undertakings, and any others using machinery explosives, or unhealthy materials	dtp,dpp,mck dpc,sp
	Public employees	. .
Iran (Islamic Republic of)	Public employees and the armed forces	mck,dpp,sp
Malaysia	Workmen's Compensation covers employees where social insurance is not operative	. .
	Exclusions: public employees and rubber holders with separate schemes	
Maldives	Employees of the Government	mcf,dpp,r
Myanmar	Workmen's Compensation operative in non-agricultural sector where social insurance is not operative	. .
Pakistan	Workmen's Compensation operative in industrial establishments with 10+ employees and earning up to PRs 3,000 a month	mck,dtc,dpc sp,dc
	Exclusions: family labour, self-employed, employees earning PRs 3,000 or more a month	. .
	Public employees, armed forces, police, local authorities authorities and railway worker	. .
Sri Lanka	Establishments in industry and commerce with 20+ employees, and contract employees	mcf,dtp,dpc sc
	Exclusion: members of police and armed forces	

Sources: See the source notes in table V.4.

Notes: dtc = cash payment for temporary disability; dtp = periodic payment for temporary disability; r = rehabilitation; dpc = cash payment for permanent disability; dpp = periodic payment for permanent disability; ds = supplement for care for permanent disability; sc = cash payment to survivors; dc = cash payment, funeral grant; sp = periodic payment for survivors; mcc = cash benefit for medical care; mck = medical care in-kind (hospital, medicine, artificial limb etc.); mcf = free medical care.

Insurance financing is required of employers in all establishments with ten or more employees, in the mining industry, and in hotels and tourist and trekking firms of Nepal. Establishments with five or more employees in the Republic of Korea have the Industrial Accident Insurance, under which premium rates paid in 1992 ranged from 0.2 to 4.0 per cent of payroll according to the riskiness of the industry. In Thailand, under the Workmen's Compensation Act, employers in establishments in industry and commerce with ten or more employees paid premium rates in 1992 which similarly varied according to risk, between 0.2 and 4.5 per cent of payroll.

Table V.7. Compulsory insurance as employer liability for employment injury

	Coverage	*Benefits*
	as defined in legislation, including specified exclusions and exemptions	*see codes in notes*
Australia	Employees, and voluntary for the self-employed	dtp,ds,mck,sc r,dpc,ds,dc
Kiribati	Employees earning $A 4,000 or less in a year *Exclusion: casual employees*	dtp,dtc dpc,pds
Nepal	Establishments with 10+ employees, hotels, and tourist and trekking firms; scheme for miners	dtp,dpc,dpp sc
Papua New Guinea	Employees in private and public sectors *Exclusion: casual employees*	dtp,dpc,ds,mcd sc,ds,dc
Republic of Korea	Establishments in industry with 5+ employees Public employees (separate scheme)	mck,dtp,dpp,dpc r,sp,sc,dc
Samoa	Employees and victims of road accidents Gasoline tax imposed to pay benefit costs for victims of road accidents	..
Singapore	Workmen's Compensation covers all manual labour *Exclusions: domestics, casual labour, family labour, salaried employees earning less than S$ 1,500 a month, and the police*	mck,dtp,dpc dps,sc
Solomon Islands	Employees aged 14+ years earning SI$ 120 a month, or working at least 6 days a month; voluntary for unemployed and self-employed aged 16-35 *Exclusion: casual employees*	dtp,dpc,mck dc or sc
Thailand	Workmen's Compensation covers establishments in industry and commerce with 10+ employees *Exclusions: employees in agriculture, fishing, public and domestic service, railroad, shipping, telecommunications, power generation and distribution, fuel oil production and refining, private education*	mcc,dtp,dpc,dpp r,sp,dc

Sources: See the source notes in table V.4.

Notes: dtc = cash payment for temporary disability; dtp = periodic payment for temporary disability; r = rehabilitation; dpc = cash payment for permanent disability; dpp = periodic payment for permanent disability; pds = supplement for care for permanent disability; sc = cash payment to survivors; dc = cash payment, e.g. funeral grant; sp = periodic payment for survivors; mcc = cash benefit for medical care; mck = medical care in-kind (hospital, medicine, artificial limb etc.); ds = supplement for dependents; mcf = free medical care.

Insurance carriers finance periodic payments of varying amounts and for varying periods for temporary disability, and lump-sum cash payments for partial disabilities of a more permanent nature in different countries. The cost of medical care is paid either as cash reimbursement as in Thailand or directly to establishments which provide the services. Rehabilitation is also cited as a benefit provision in Australia, the Republic of Korea and Thailand. In case of death due to occupational injury or disease, benefits for survivors are also available. While this is usually a lump-sum cash payment, in Thailand it is a pension payable for five years. A dependent supplement is paid for children under the age of 16 years in Papua New Guinea. Survivors benefit may be supplemented by an additional cash payment, which is usually intended as a contribution to funeral costs.

Social insurance maintaining employer liability

Social insurance maintaining employer liability is the approach adopted for employment injuries in China, Myanmar, the Philippines and Viet Nam. Indonesia and Malaysia combine employer liability, both through social insurance and direct liability. The labour insurance system in China covers permanent and contract employees in state enterprises located in urban areas for this contingency together with other contingencies. In Pakistan, employees in establishments and industries receive benefits from an employer liability type social insurance, which covers only employees earning less than a specified monthly income. Family labour and the self-employed are specifically excluded. Similarly, in Myanmar employees in selected establishments with five or more employees in 61 districts are covered under employer liability type insurance.[17]

In 1993, Indonesia's Employees Social Security extended coverage beyond that shown in table V.8 by introducing compulsory schemes for all employers and employees and obliging employers to insure for employment-related accidents. With effect from July 1992, Malaysia amended its Employees Social Security Act to extend coverage to all establishments employing one or more employees, all aborigines, any person whose principal employment is as a fisherman in maritime waters, and agricultural workers employed in cultivating and harvesting paddy fields.[18] Bangladesh and Nepal are currently considering recommendations for the replacement of employer liability for direct compensation by social insurance.

Types of benefits under employer liability of social insurance are usually similar to those under compulsory insurance with commercial carriers. Medical care and treatment costs are usually partially covered. A periodic payment of varying amounts for a limited period replaces income lost due to temporary disability in most countries; the same applies for permanent disability, although a cash payment is also made in Indonesia and Viet Nam. In addition, Malaysia and the Philippines provide a supplementary benefit for dependents or special care requirements of the permanently disabled. Rehabilitation benefits are also provided in China, Malaysia and the Philippines. Survivors benefits are available in all countries, most frequently as a pension supplemented by a cash payment. A cash payment for funeral expenses in case of death is provided in Malaysia and the Philippines.

In China, the enterprises are increasingly assuming responsibilities for insurance through pooling among themselves, with the Government providing subsidies as needed. In Viet Nam, employees in the state sector receive injury benefits paid from the Welfare Fund that is financed by a contribution from enterprises set at 0.8 per cent of payroll and an administrative subsidy from the Government of 0.3 per cent of payroll.

In many countries, rather than a flat rate, varying rates apply according to, *inter alia*, wage classes or the riskiness of the industry for insurance contributions. Indonesia, Malaysia, Myanmar, Philippines and Thailand use such rate gradations. In Indonesia, employer contributions to Employment Accident Insurance varied between 0.24 to 3.6 per cent in 1992 according to the relative riskiness in 10 industrial classifications.[19] Thailand reformed

[17] International Labour Office, "Final report of ILO/UNDP sectoral review mission to Myanmar" (Bangkok, August 1989).

[18] *Asian News Sheet*, loc. cit.

[19] Kartonegoro, op. cit; and International Labour Office, "Report to the Government on social protection in Indonesia" (Geneva, 1993), p. 23.

Table V.8. Social insurance with employer liability for employment injury

	Coverage	Benefits	Contributions [a]		
	as defined in legislation, including specified exclusions and exemptions	*see codes in notes*	*Employee (% of earnings)*	*Employer (% of payroll)*	*Government (% of payroll)*
China	Labour insurance covers permanent and contract employees in state enterprises	mck,mcc,dtp r,dpp,sp,sc	none	entire cost	subsidies *as needed*
Indonesia	Establishments with 10+ employees, or payroll of Rp 1 million or more a month; voluntary coverage available	mck,mcc dtp,dpp,dpc	none	0.24 - 3.6 industry risk	none
Malaysia	Establishments with 1+ employees, all aborigines, fishermen, agricultural employees in paddy rice	mck,dtp,dpp r,ds,sp,dc	none	1.25 24 wage classes	none
Myanmar	Establishments in industry, commerce, service with 5+ employees in 61 districts, and being extended	mck,mcd,dtp dpp,dpc,sp	none	1 6 wage classes	none
Pakistan	Employees in selected establishments and industries earning PRs 3,000 or less a month *Exclusion: family labour, self-employed, earning PRs 3,000 or more a month*	mck,mcc,dtp dpp,sp,dc	none	7 *also finances sickness and maternity benefits*	none
Philippines	Employer Compensation covers employees, including seafarers; voluntary for self-employed *Exclusions: domestics, family labour, non-contributing self-employed*	mck,dtp,dpp r,dpc,ds,sp,dc	none	1 8 wage classes	none *as employer*
Viet Nam	Welfare Fund covers employees in state sector	dtc,dtp,dpc dpp,sp,sc	none	0.8	0.3 *for administration*

Sources: See the source notes in table V.4.

Notes: dtc = cash payment for temporary disability; dtp = periodic payment for temporary disability; r = rehabilitation; dpc = cash payment for permanent disability; dpp = periodic payment for permanent disability; ds = supplement for dependents, or for special care requirements of the permanently disabled; sc = cash payment to survivors; dc = cash payment, funeral grant; sp = periodic payment for survivors; mcc = cash benefit for medical care; mck = medical care in-kind (hospital, medicine, artificial limb etc.).

[a] Contributions may also finance other benefits as indicated. The rate of contribution is a statutory requirement.

its Workmen's Compensation Act in 1994, replacing the 1972 legislation, to create a Workmen's Compensation Fund from which benefits are to be paid. It stipulates premium rates ranging from 2 per cent in the construction as the most risky industry to 0.2 per cent for the safest sectors, such as office work. One objective of the reform is accident prevention. Therefore, if there is a reduction in the incidence or seriousness of accidents, insurance premiums could be lowered; however, if the record worsens, the premiums will be adjusted upward.

Social insurance with joint financing

In many countries, social insurance for employment injury benefits is financed by employers, employees and sometimes the Government (see table V.9). Most Central Asian republics, the Islamic Republic of Iran, Japan and New Zealand are examples. These countries do not offer any other option. In June 1993, Viet Nam announced plans for social insurance which will be financed

Table V.9. Social insurance with joint financing for employment injury

	Coverage: as defined in legislation, including specified exclusions and exemptions	Benefits: see codes in notes	Contributions[a]: Employee (% of earnings)	Employer (% of payroll)	Government (% of payroll)
Afghanistan	Employees in all occupations using machinery in private establishments, cooperatives, social organizations, joint enterprises and government	mcc,dtc dpc,sc	1	Af 500 one time and deficit	none
Armenia	Employees, and members of state cooperatives and farms	dtp,dpp,r mck,sp	1	12.1-26 by industry	subsidies as needed
	Self-employed	(same)	26		
			also finances all other benefits		
Azerbaijan	Same as for Armenia				
India	Employees State Insurance covers establishments using power with 10+ employees earning Rs 3,000 a month; if no power is used 20+ employees; covers employees in 609 industrial centres	dtp,dtc mck,mcc dpp,dpc sp,dc	2.25 *also finances sickness and mcd*	4	12.5 of medical costs
	Retired and disabled employees	..	Rs 10 a month	4	none
Iran (Islamic Republic of)	Employees in industry, agriculture and minng	mck,dtp dpp,sp,dc	7	20	3[b]
	Seasonal employees, voluntary for self-employeed		9	20	3[b]
			also finances old age, invalidity and survivors benefits		
Japan	Establishments in industry and commerce not covered by voluntary or special schemes	dtp,dpp mck	none	0.5-14.5 accident rate	subsidies
	Establishments in agriculture, forestry, fishing Voluntary for those with less than five employees	sp,sc,dc	..	..	..
	Self-employed, seamen, and public employees		..	..	..
Kazakhstan	Employees	dtp,dpp mcc,mck	1	37	subsidies
			finances all benefits		
Kyrgyzstan	Employees in public and private sectors, students, and members of cooperatives	dtp,dpp r,sp,mck	none	5.2	*as employer*
Mongolia	Employees, and voluntary for self-employed	dtp,dpp,sc	none	13.4	50 of costs
			finances all benefits		
New Zealand	All residents covered for personal injury and accidents (employment and non-work related) and for incapacity at birth or during illness	dtp,dpp mck,r sp,sc	premium on non-work incapacities	obligation by risk 1.71 in 1992	
Tajikistan	Same as for Armenia				
Turkmenistan	Employees in enterprises	dtp,dpp,r mck,sp	1	37	*as employer*
	Members of cooperatives and state farms		1	26	
			finances all benefits		
Uzbekistan	Employees, and members of state cooperatives and farms	dtp,dpp,r mck,sp	1	37	*as employer*
			finances all benefits		

Sources: See the source notes in table V.4.

Notes: dtc = cash payment for temporary disability; dtp = periodic payment for temporary disability; r = rehabilitation; dpc = cash payment for permanent disability; dpp = periodic payment for permanent disability; pds = supplement for care for permanent disability; sc = cash payment to survivors; dc = cash payment, funeral grant; sp = periodic payment during survivors; mcc = cash benefit for medical care; mck = medical care in-kind (hospital, medicine, artificial limb etc.); mcf = free medical care.

[a] Contributions may also finance other benefits as indicated. The rate of contribution is a statutory requirement.

[b] Government also pays contributions for first 5 employees in small industrial and technical workshops.

by contributions from employers and employees replacing its current employer liability, and covering employees in administrative and professional offices, the armed forces, political organizations, private enterprises with more than ten persons, enterprises with foreign investment and other foreign agencies.

In New Zealand, all residents are also protected against personal injuries and accidents, incapacity at birth or due to illness, not related to work. In Japan, employees in industry and commerce, and establishments in agriculture, forestry and fishing with five or more employees, and the self-employed farmers, carpenters and forestry workers using machine power are generally covered by insurance. Those with less than five employees can join voluntarily. The Employees State Insurance in India covers establishments in 609 industrial centres with 10 or more employees if they use power, or with 20 or more employees if power is not used. The Social Security Organization in the Islamic Republic of Iran covers employees for injuries as for other contingencies in industry, mining and agricultural sectors. In most Central Asian republics and Mongolia, all employees are protected by law against employment injury and related losses. The self-employed can also join insurance schemes voluntarily in some cases as in Mongolia.

Countries which use joint financing of insurance schemes also offer similar types of benefits as in other insurance plans. They include cash compensation, and medical and rehabilitation costs. In India, both lump-sum and periodic payments are provided. In New Zealand, survivors receive a cash payment and a pension. The Central Asian republics and New Zealand also finance rehabilitation.

The manner of sharing insurance costs by employers, employees and public authorities differs from country to country. In the Central Asian republics, as market-oriented reforms are implemented, employers are becoming responsible for the payment of payroll taxes that are pooled to finance the whole range of social security contingencies and not for employment injury alone. Governments are responsible as employers, and for subsidies as needed for other employees. A flat rate is used for the financing of social insurance in the Islamic Republic of Iran where it also covers old age, invalidity and survivors. In Japan, rates of contribution from employers are based on the accident record of establishments. In India, the employers and employees finance the Employees State Insurance that also covers sickness benefits and medical care for dependent members of the family. The Government contributes a percentage of payroll to finance medical costs. A special scheme for retired and disabled employees in India is financed by employers' contributions as a percentage of payroll and by a monthly contribution from employees with no government contribution. The Life Insurance Corporation and the General Insurance Corporation of India offer group insurance to several groups to protect them from a number of contingencies including employment injury and related losses (see box V.2).

SICKNESS AND MATERNITY BENEFITS

Sickness involves medical care and replacement for the loss of income due to incapacity to work. A similar need for care and compensation for losses relating to pregnancy, confinement and infant care were recognized in the first set of international labour standards adopted during the early part of the twentieth century. Despite that recognition and experience since then, this is an area where developing countries still lag in effectively meeting the demand, both within and outside the formal employment of women. Maternity and child care assume special significance for women who are employed in jobs outside the home.

A related concern is maternity leave during pregnancy and following childbirth, necessary for maintaining, restoring or improving the health of women and their ability to work and attend to personal needs. Maternity leave with at least partial payment of wages or salaries (earnings replacement or protection) is allowed for varying periods before and after confinement. Several countries support international standards of a maternity leave of 12 weeks, with six weeks after birth. Some countries also have legal provision for nursing breaks beyond maternity leave to encourage women employees to breastfeed their infants, as in Japan, India, Lao People's Democratic Republic, Mongolia, the Philippines and Sri Lanka.

In response to persistent allegations of termination due to pregnancy and of employers offering severance pay instead of maternity benefit, legislative provisions now prohibit dismissals during periods within pregnancy and after birth. These periods are variously designated in the laws of different countries. Dismissal is prohibited during the duration of maternity leave in Australia, Cambodia,

Box V.2. Extending social security protection to the workers of informal sectors

Administrative and financial feasibility is a major consideration in extending social security protection to the relatively less well off but numerically large working population in the informal sectors of the economies in the region. It is relatively easy to make employers in the organized sectors statutorily responsible for contributions and enforce compliance with other legal and administrative requirements. This approach is difficult, if not impossible to apply, for social security coverage for people in the informal sectors. The reasons are that employment in these sectors is often irregular, payment capacity low, compilation of earnings difficult, and many of the workers are self-employed.

In spite of these difficulties, many developing countries in the region have attempted to provide limited social security protection to selected groups of workers in the informal sector through various schemes and programmes. Typically these schemes involve some amount of government subsidy. Minimizing such fiscal cost would be a key determinant of the expanded coverage of people engaged in the informal sector.

In India,[a] several ways have been tried to offer insurance coverage to such workers at nominal cost with limited or no government support. The special features of these alternatives may provide some lessons in how the problems inherent in extending social security protection to workers in informal sectors could be overcome. The schemes are sponsored by the Government of India and the state governments with the participation of local government bodies, the state-owned insurance corporations, and cooperative bodies or associations of the concerned groups of workers.

For example, a group accident scheme for active fisherman is sponsored by the Government of India and covers all active fishermen between the ages of 18 to 65 years holding a licence to fish. The scheme is implemented in collaboration with the General Insurance Corporation of India and its subsidiaries, the National Federation of Fishermen's Cooperatives Limited (FISHCOPFED) and other fishermen's cooperatives, and the state governments. FISHCOPFED is the focal organization of the scheme. A fishermen's cooperative society or any other organization recognized by the Government or FISHCOPFED can sponsor the insurance scheme for the fishermen registered with it. The insurance company issues a group policy in favour of FISHCOPFED and the sponsoring agency. A group insurance premium is paid by the sponsoring agency to FISHCOPFED which, in turn, pays to the insurance corporation. The premium is shared by the insured fishermen through their sponsoring body (25 per cent), the state government (25 per cent) and the central Government (50 per cent). The individual fisherman's premium payment is thus kept to the minimum. The benefit package consists of cash compensation in the event of death or total or partial disablement.

In case of death or disablement of an insured fisherman, the sponsoring agency will submit the claim to FISHCOPFED which, in turn, will settle the claim with the insurance company within one month of submission. FISHCOPFED then channels the benefit to the claimant fisherman or his nominee through the sponsoring agency.

The Life Insurance Corporation of India also has introduced a number of group insurance schemes to provide inexpensive insurance cover to some sections of workers through their own cooperative organizations. In their cases also the master policy is issued to a cooperative society, an association or body, which assumes the responsibility for collecting and remitting the premiums to the insurance company and, in the event of death, for the settlement of the claims.

One such scheme is the Life Insurance Protection for Employees of Shops and Establishments, available in a number of cities in the state of Gujarat. Low-salaried employees of small shops and establishments are granted statutory life insurance protection under the Gujarat Shops and Establishments Act of 1980. The scheme is coordinated by the municipal corporations or committees which are empowered by the Act to collect annual premiums from the employers (small shop owners) and remit them to the life insurance corporation. Half of the annual premium is recovered by the employers from the employees in monthly instalments and half is contributed by the employers themselves. The municipal corporations or committees are also responsible for processing the claim in the event of the death of the insured person.

The Doodh Sagar Dairy Milk Producers Group Insurance is another example of group life insurance facilities offered to another disadvantaged social group. Under this scheme, group life insurance cover is provided to the members of primary milk producers cooperative societies in Mehsana district of Gujarat state. Milk producers in a village form a village-level cooperative society. These village societies form an apex society at the district level. The annual premium for the group scheme is paid to the insurance company by the apex society. The apex society, in turn, collects premiums from the village-level societies. Village cooperatives bear the responsibility of collecting premiums from their members who are sponsored for insurance. Of the total premium, 45 per cent is paid by the members, 25 per cent by the

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[a] Sahadev K. Wadhawan, *Social security for workers in the informal sector in India* (Geneva, International Labour Office, 1989).

village society and 30 per cent by the apex society. In the event of death, claims from the insurance company are processed by the apex society and channelled to the beneficiaries through the village-level cooperatives.

Latest available records of coverage and results of financial operations indicate both the organizational and financial viability of all these schemes. These demonstrate sustainable ways for extending social security protection to groups of workers in the informal sectors who are engaged in low-paying occupations in urban or rural areas. It is the "group" aspect which makes the schemes appropriate in the context of the informal sector. The insured workers pay a much reduced premium on account of risk sharing within the group. Moreover, it is practical for insurance companies to deal with an organized group entity rather than individuals. It is often difficult for companies to make contacts with the workers of the informal sector, many of whom do not possess regular jobs or formal contact addresses.

Workers in the informal sector often organize themselves in groups for certain purposes, such as for registration or licensing as small traders; for access to credit; for organizing some common business activities such as a joint storage space; or for representing the interests of the group with the local authorities. Any such group could facilitate organizing a group insurance scheme. Some such groups have better and somewhat formal organizational structures, such as having a registered office address. These attributes make them more suitable to deal with insurance matters.

Cooperative societies are one such convenient group, common in the informal sector, particularly in agriculture, in many countries. Most members of a particular cooperative have similar occupations and face similar seasonalities in income generation. For this reason, it may be easier for the cooperative to time the collection of premiums in an effective manner. Peer pressure also helps in the collection. The premiums collected from individual members can also, at times, be augmented from other funds which the cooperative may generate. With regard to benefits, the workers often lack the means and capabilities for processing formal insurance claims. This task can be undertaken by the sponsoring cooperative which would also take responsibility for ensuring that benefits reach the individual. To deal effectively with insurance companies, various tiers of cooperative societies at different levels, for example, village, district, or state, may be required, especially for rural areas.

In urban areas, local representative bodies empowered by government legislation could also administer statutory insurance schemes. As employers and employees of informal sectors are engaged in scattered small businesses and disparate activities, these bodies are well suited for mobilizing contributions and dispensing benefits.

Group insurance schemes can be designed to cover not only the loss of life, but also a variety of other insurable circumstances, such as sickness, maternity and disability or loss of assets. With a sufficient number of persons involved, which is possible to achieve through innovative organizational efforts, the group insurance premium can turn out to be low and affordable for the workers. As a result, such schemes can be operated with no or minimal financial support from the Government and can be sustained from the workers' contributions.

Government agencies, however, have to provide institutional and legal support to these schemes. Such support includes promulgation of appropriate legislation and the registering and monitoring of cooperative societies and other local bodies who are the focal points for the schemes. Governments could also consider providing a sliding scale of matching contributions for new schemes to encourage the extension of group insurance to currently uncovered groups of informal sector workers.

China, India, Pakistan and the Lao People's Democratic Republic. Several of these countries allow this prohibition for further extended periods for women to care for their babies and to fully restore their own health. Singapore prohibits dismissal three months before childbirth, and New Zealand prohibits dismissal altogether because of pregnancy. In Japan the prohibition extends through pregnancy and thirty days thereafter. Mongolia protects women employees against dismissal during the nursing period until the child is one year old. Women in the Philippines are protected during the three months before childbirth.

Legislation in most countries requires employers to provide for sickness and maternity benefits either as a direct liability, or by using social insurance (table V.10) which may be financed by groups of employers or jointly by employers, employees and sometimes the Government. Apart from medical care, employers are obliged to replace incomes lost during sickness or maternity-related conditions, either as paid leave or a lump-sum cash payment. The number of occasions and the period for which leave or compensation are allowed vary from country to country. Half of the pay for 12 weeks in Indonesia, wages for 45 days for a maximum of two pregnancies in Nepal, and full replacement of income for 60 days up to four children in Singapore, are some examples of these variations.

Table V.10. Financing techniques for sickness and maternity benefits

Employer liability		*Social insurance*		*Social Assistance*
Direct liability	*Compulsory insurance*	*As employer liability*	*With joint financing*	
China	Nepal	Armenia	Afghanistan	Australia
Hong Kong	Republic of Korea	Azerbaijan	India	India
Indonesia		Bangladesh	Iran (Islamic Republic of)	New Zealand
Malaysia		China	Myanmar	
Maldives		India	Philippines	
Pakistan		Kazakhstan	Thailand	
Sri Lanka		Kyrgyzstan	Japan	
		Mongolia		
		Pakistan		
		Tajikistan		
		Turkmenistan		
		Uzbekistan		

Sources: See the source notes in table V.4.

In Bangladesh, China, Pakistan and in the Central Asian republics, social insurance covers sickness and maternity benefits (see table V.11). In Bangladesh, payment of a cash benefit based on wages is allowed together with a maternity leave for 12 weeks, including six weeks after confinement. The Philippines recently provided for full replacement of income for a maximum of four children along with a 60-day maternity leave in each case, or 78 days for a caesarian delivery. Thailand recently adopted legislation to extend the length of maternity leave from 60 to 90 days beginning in 1995. The labour insurance schemes in China pay a lump sum to supplement replacement income during a maternity leave of 90 days. China also finances the cost of prenatal care, confinement and post-natal care from the state budget. In Viet Nam, maternity benefits for public sector employees are paid from the Welfare Fund to replace income for a period of eight weeks.

Among the Central Asian republics, Uzbekistan is currently reforming its maternity care structure, with potential changes in the role of the Government in health protection. Kyrgyzstan has reformed its scheme since independence, with the introduction of a new health insurance law in 1992. Pending implementation of the new law, imposition of a payroll tax on employers, and state and collective farms continues to finance maternity benefits.

The Social Security Organization in the Islamic Republic of Iran implements legislation covering employees for benefits in sickness and maternity cases. Employers, employees and the Government jointly finance insurance for maternity benefits in Japan also, where maternity benefits are available to the spouse of an employee. Maternity leave of 14 weeks, eight weeks following confinement, is allowed. A lump-sum birth grant equivalent to basic wages for one month and a nursing grant are also among the benefits allowed.

Sickness benefits in Australia are paid from general revenues. A maternity leave of 12 weeks is provided in law, with provision for at least six weeks after confinement. It also provides for income replacement, with extended unpaid leave if needed. New Zealand allows maternity leave for 26 consecutive weeks, with at least 20 weeks after confinement. All pregnancy and childbirth services, from the first antenatal visit through to labour and delivery, are provided free of charge as part of a comprehensive, publicly funded family health service in New Zealand. By that standard the developing countries' maternal and infant health care and protection fall far short.

Table V.11. Sickness and maternity benefits with social insurance

	Coverage	Benefits	Contributions[a]		
	as defined in legislation, including specified exclusions and exemptions	*see codes in notes*	*Employee (% of earnings)*	*Employer (% of payroll)*	*Government (% of payroll)*
Afghanistan	All citizens	si,mi	0.5-1.0	other cost	none
			also finances medical care		
Armenia[b] **Azerbaijan**[b] **Kazakhstan**[b] **Tajikistan**[b] **Turkmenistan**[b] **Uzbekistan**[b]	Employees of enterprises, state farms, collectives, and students	si,mi	1	12.1 to 26	subsidies
	Self-employed	si,mi	27		subsidies
			also finance old age, invalidity, survivors and family allowances		
Bangladesh	Sickness: establishments in manufacturing with 10+ employees; employees in shops and establishments with 5+ employees *Exclusion: clerical staff*	si	none	entire cost *sometimes medical facilities*	medical facilities *public hospitals*
	Maternity: employed women	mi	none	entire cost	none
China	Employees of state enterprises (permanent and contract employees)	si,mi	none	entire cost	none *hospitals*
India	Employees State Insurance covers non-seasonal factories using power with 10+ employees, and not using power with 20+ employees in 609 industrial centres, and extended gradually *Exclusions: employees in seasonal, agricultural and specific other sectors; employees earning Rs 3,000 or more a month*	si,mi si for pf	1.5	4	12.5 of medical benefits *and medical facilities*
			also finances medical cash benefits		
	Employer liability maintained for employees not covered by social insurance or by welfare funds	mi	none	entire cost	none
Iran (Islamic Republic of)	Employees in urban areas and pensioners are covered by Social Security Organization scheme	sic,mi bc	7	8	20 c
			finances all benefits		
Japan	Employees Health Insurance covers establishments in industry and commerce Voluntary for other employees	si,mi bc ms	4.1	4.1	13 of benefit costs administration
	Members of insurance societies		3.583	4.665	none
Kyrgyzstan	Employed persons	si,mi	none	5.2	entire cost of medical care
	Members of state and collective farms	si,mi	none	3.6	
	Students	mi	none	..	
Mongolia	Employees of state and private enterprises, cooperatives, government employees, military personnel, students, and citizens working for joint ventures, embassies, international agencies	si,mi	none	13.5	*as employer*
			also finances old age, invalidity, survivors family allowances, social assistance child care, infant-care benefits		
Myanmar	Establishments with 5+ employees in industry and commerce in specified industries and services in 61 districts, with gradual extension	si,mi	1.5	1.5	subsidies *as needed*
Pakistan	Provincial Social Security scheme covers firms with 10+ employees in selected industries *Exclusions: family labour, self-employed, earning above Rs 3,000 a month*	si,mi	none	7	none
			also finances work injury, medical facilities		

(Continued on next page)

Table V.11 *(continued)*

	Coverage	*Benefits*	*Contributions*[a]		
	as defined in legislation, including specified exclusions and exemptions	*see codes in notes*	*Employee (% of earnings)*	*Employer (% of payroll)*	*Government (% of payroll)*
Philippines	Employees, including seafarers aboard foreign vessels, through the Social Security System (SSS)	sl,ml	3.3	4.7 + 0.4 for maternity	3.3
			also finances old age, invalidity and survivors		
	Permanent female civil servants	ml	none	*government*	entire cost
	Exclusions: self-employed in SSS, domestic servants, government employees in GSIS, agricultural labour and family labour				
Thailand	Establishments with 20+ employees, maximum earnings: B500 a day; voluntary for self-employed	sl,ml,ms	1.5	1.5	1.5
			also finances invalidity, survivors and medical care		
	Exclusions: employees in agriculture, fishing, public and domestic service, railroad, shipping, telecommunications, power generation, and distribution, fuel oil production and refining, private education				

Sources: International Labour Office, "Mongolia: Report to the government on social protection" (MON/91/MO2/NET/01) (Geneva, 1993) and "Final report of ILO/UNDP sectoral review mission to Myanmar" (Bangkok, ILO Regional Office, August 1989), pp. 40-49; H.B. Inductivo and F.E. Villaruz, "National strategies for the extension of social security to the entire population: The Philippine experience" (ISSA/ASIA/RM/92/2 – Philippines) (Manila, International Social Security Association, 1992); see also the source notes in table V.4.

Notes: sl = sick leave cash, as periodic or lump sum payment; ml = maternity leave with replacement income (partial or full) as lump sum benefit or as periodic payment for specified period; bc = cash payment at birth (e.g. birth or nursing grant); sl for fp = sick leave cash benefit as replacement income to cover complications of family planning, with additional days depending on sterlization operation; mmc = maternity medical care as cash payment; ms = maternity benefit for the spouse of an employee.

[a] Contributions may also finance other benefits as indicated. The rate of contribution is a statutory requirement.
[b] Republics in Central Asia, except Krygyzstan: 1990 amendments only. Information about changes is not yet available.
[c] Government also pays contributions for first 5 employees in small industrial and technical workshops.

MEDICAL CARE

Medical care is a basic need for the vast majority of the region's population. Throughout the region, countries have made efforts to improve the health of the people by the extension of medical facilities, the development of public health programmes, the spread of health education, increased availability of safe drinking water and the improvement of nutrition and sanitation. However, issues relating to the unification of medical care services, elimination of their inequitable anomalies, and the extension of public medical care service to all sections of the population without prejudice to the right to have private medical care at one's own expense are yet to be fully resolved.

From the point of view of meeting health needs, specific types of medical care such as for employment-related sickness and injury, special health needs of the elderly, the invalid, the widows and the orphans have been the major concerns of social security. Its scope, however, could be extended and that could play a part in the achievement of the objectives of Strategies for Health for All by the Year 2000.[20] One of the major justifications for the intervention in the health arena with

[20] World Health Organization, "Financing of health services", Technical Report Series No. 625, Annex 5 (Geneva, 1978); and K. Prasad, "Medical care programmes under social security" (ISSA/ASIA/RTC/KL/VI)(Kuala Lumpur, May 1991).

social security type measures is that it creates new and continuing allocations of resources that otherwise would not be available through health budgets. It stimulates and promotes the building of hospitals, clinics, dispensaries and related facilities. Since it promotes the health of the economically active population so protected, it is also a contribution to the increased productivity needed for economic development.

The financing of health care presents a common problem in developing countries today. There are various ways for providing medical care under social security. First, throughout the ESCAP region, employers, and especially Governments as employers, assume direct liability for providing medical care to their employees, although the extent and the quality of care or compensation may vary widely. Some employers do so through the establishment of medical facilities on or near the place of employment. Second, employers voluntarily take out health insurance cover for their employees or as a compulsory requirement under the law. Social insurance, financed jointly by groups of employers, or by shared contribution from employers, employees and sometimes the Government, also covers medical care and benefits either separately or as part of the national insurance systems along with a number of other contingencies (see table V.12). Also social assistance from general revenues is provided for medical care. In some cases, specific taxes are levied and earmarked to finance medical care for specific groups of employees.

Table V.12. Financing techniques for medical care

Employer liability	*Social insurance*		*Social assistance*
	As employer liability	*With joint financing*	
Afghanistan	Armenia	India	Australia
Bangladesh	Azerbaijan	Indonesia	Hong Kong
China	China	Iran (Islamic Republic of)	India
Hong Kong	Indonesia	Japan	Japan
Indonesia	Kazakhstan	Myanmar	New Zealand
Maldives	Kyrgyzstan	Philippines	Republic of Korea
Nepal	Pakistan	Thailand	
Pakistan	Tajikistan	Republic of Korea	
Sri Lanka	Turkmenistan		
	Uzbekistan		

Sources: See the source notes in table V.4.

As is the case for other contingencies, Governments assume direct liability for the medical care of their employees in many countries (table V.13). The range of benefits available in cash or kind differs greatly. In Hong Kong, medical care for all employees is a direct employer liability. Most other countries maintain employer liability for only a segment of the economically active population. In many countries, larger employers and state enterprises operate medical facilities for their employees. Labour welfare centres in industrial locations in Bangladesh, for example, have attached medical units where employees and their dependents receive treatment. Legislation may require employers to furnish medical facilities, as it does for plantation owners in Sri Lanka. Governments in most cases supplement these provisions with free public facilities, especially in hospitals.

Although few people may need health care at any one time, all people are at risk at all times. Pooling of these risks by sharing resources in a common fund among large groups of people with different probabilities for needing medical care is social insurance. Such insurance could be organized by groups of employers, employers retaining sole liability, or could be jointly financed by employers and employees. With employees

Table V.13. Medical care as direct employer liability

	Coverage	*Benefits*
	as defined in legislation, including specified exclusions and exemptions	*see codes in notes*
Afghanistan	Employees in large establishments which maintain their own medical facilities	mck
Bangladesh	Medical facilities provided by some employers in both public and private sectors	mcd, mck or mcc=100 taka
China	Employees of government and party organizations, employees of educational, scientific, and cultural institutions, and university students	mck,mcf
Hong Kong	All employees	mck
Indonesia	Manage Health Care Insurance is a direct liability of smaller employers	..
Maldives	Government employees	mcc,mcf
Nepal	Employees in factories on industrial estates with 10+ employees; and certain hotels, tourist and trekking firms	mcc,mck
Pakistan	Public and railway employees, armed forces, local authorities and police	..
Sri Lanka	Plantation owners provide medical care in their own dispensaries and maternity wards	mck mcf

Sources: J.R. Marzolf, "National health insurance schemes: comparison of the Indonesian JPKM strategy with selected countries", paper presented at the Workshop on Social Security (January 1994); International Labour Office, "Report to the Government on social security planning and administration: Nepal" (NEP/85/026/1) (Geneva, 1992), p. 7; see the source notes in table V.4.

Notes: mcc = cash benefit for medical care; mck = medical care in-kind (treatment in clinic or hospital, medicine, artificial limb etc.); mcf = free medical care in public clinics and hospitals; mcd = medical care is provided to dependents; dc = cash payment to survivors (e.g. funeral grant).

participating in financing, dependent members of their families are able to benefit. Social insurance coverage for health, to the extent it exists now in countries of the region, is partial and segmented, confined mostly to limited groups of the employee population.

Japan was the first non-western country to introduce health insurance in 1922, and the first to achieve universal health cover in 1961. Thus, everyone is covered by one of the five schemes which comprise Japan's national health system. Employers and employees finance a scheme of Employees Health Insurance. The self-employed and others are covered under a separate scheme. A third insurance scheme, initiated under the Health Services for the Elderly Act (1983), pays all health expenditures for those aged 70 years and over. Special schemes operate for seamen, government employees, private school teachers and employers. All residents not under these special schemes are covered under local government schemes (i.e., municipal, township or village).

Health care in India includes government insurance schemes for central government employees and industrial workers.[21] The Central Government Health Scheme covers about 4 million with medical

21 R. Chander, "Cost-containment measures under social security medical care schemes" (ISSA/ASIA/RC/91/3) (International Social Security Association, Jakarta, September 1991).

care through hospitals, some of which are owned by the social security organization in metropolitan areas and managed by the Government. The Employees State Insurance introduced in 1952 is the major health insurance scheme in India. It covers 7 million employees and caters to their family members, thus covering 27 million people or 3.3 per cent of the total population in India. The scheme provides a full range of medical benefits through a network of more than 1,300 dispensaries and more than 100 hospitals. The insurance scheme covers non-seasonal factories with compulsory contributions of 5.5 per cent of earnings shared by employers (4 per cent) and employees (1.5 per cent). The state Governments contribute 12.5 per cent of expenditures on medical care only.

The health insurance system in the Republic of Korea covers nearly 93 per cent of the total population. The scheme for industrial enterprises is financed by payroll taxes levied equally on employers and employees. Medical insurance for government employees and private school teachers is financed by employees with matching contributions by the Government. The Government also finances half the costs for the self-employed in regional medical insurance covering rural areas. The rates vary by income, assets and number of dependents in the household.[22]

In the Philippines, the medical care component of social insurance for employees in the private sector under the Social Security System and for government employees under the Government Service Insurance System are combined into the Philippine Medicare Programme financed by employers and employees, with the Government making up any deficits.[23] The Social Insurance Organization in the Islamic Republic of Iran operates clinics and hospitals for urban employees. The Government also finances the employers' share of contributions for the protection of employees in small workshops and also for a Vulnerable Group Medical Insurance scheme. Rural residents are covered by the Rural Social Insurance.

The benefit provisions of these schemes vary widely. Most schemes combine cash benefits with in-kind service in clinics, hospitals and other facilities owned by the concerned employers, or contracted care is provided in public or private facilities.

A common feature of health schemes in the ESCAP region is their provision of medical care to families (see table V.14). Health insurance in Japan provides for dependent family members. The Employees State Insurance scheme in India covers spouses but requires an additional monthly contribution. In March 1992, Employees Social Security was introduced in Indonesia with a health maintenance scheme covering employees and their dependents in the private and public sector. It involves "managed care" under Guaranteed Health Maintenance of the People.[24] The premium for the basic benefit is set by the Government on a provincial basis with a system of inter-provincial cross subsidy, taking account of disparities in economic and health status among provinces. It is financed by employers, with costs beyond a basic package of medical care for families to be paid for by the employee. Papua New Guinea recently established a voluntary medical insurance scheme by tripartite agreement. Samoa is forming a National Health Insurance Scheme to make affordable care available to all.

In the economies in transition, health care is provided by a combination of public health services and medical facilities in state enterprises and co-operatives (table V.15). In 1992, Mongolia replaced free medical care financed by the employers and the Government by introducing charges for thirty services. A national health insurance financed by employers and employees is currently under consideration in Mongolia. In Uzbekistan, the Government subsidizes health care and pharmaceuticals, but in place of health care previously provided free of charge, user charges were introduced for most medical services in 1993.

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22 Oh-Young Park, "Cost-containment measures under social security medical care schemes: national experience of the Repubic of Korea" (ISSA/ASIA/RC/91/3 – Republic of Korea) (Jakarta, September 1991), p. 1. Tae-Won Park, "Cost-containment measures in the provision of hospital care under social security health care schemes: national experience of the Republic of Korea" (ISSA/ASIA/RM/90/2 – Republic of Korea) (Izmir, International Social Security Association, October 1990).

23 H.B. Inductivo and F.E. Villaruz, op. cit., p. 18.

24 J.R. Marzolf, "National health insurance schemes: comparison of the Indonesian JPKM strategy with selected countries", paper presented at the Workshop on Social Security (January 1994).

Table V.14. Joint financing of social insurance for medical care

	Coverage: as defined in legislation, including specified exclusions and exemptions	Benefits: see codes in notes	Contributions[a]: Employee (% of earnings)	Employer (% of payroll)	Government (% of payroll)
India	Employees State Insurance covers non-seasonal factories using power with 10+ employees, and not using power with 20+ employees in 609 industrial centres, and extended gradually *Exclusions: employees in seasonal, agricultural and specific other sectors; employees earning Rs 3,000 or more a month*	mck,mcc mcd dc	1.5 spouses = Rs 10 a month disabled = Rs 10 a month retirees = Rs 10 a month	4 *also finances sickness and maternity*	12.5 of medical benefits and medical facilities
Indonesia	Health maintenance scheme of Employees Social Security covers all employees	mck,mcc mcd	cost of basic care	6 or 3 *married/single*	administration *as employer*
Iran (Islamic Republic of)	Employees in urban areas and pensioners are covered by Social Security Organization scheme	mck,mcc mcd	7	8 *finances all benefits*	20[b]
	Rural Social Insurance covers rural residents	..	Rls 365 a year	none	costs
	Civil Servants Medical Insurance scheme covers government employees	..	..	*government*	..
	Vulnerable Group Medical Insurance scheme (criteria for coverage is not available)	..	..	..	..
Japan	Employees Health Insurance covers establishments in industry and commerce; voluntary for others	mck,mcd	4.1	4.1	14.6 of benefit costs
	Members of insurance societies		3.83	4.665	none
	Employees of government, private schools, seamen	mck,mcd	..	*government*	..
	National Health Insurance covers all residents not financed by other schemes	mck	annual fee[c]	none	50 of benefit costs administration
Myanmar	Establishments with 5+ employees in indusry and commerce with employees in specified industries and services of 61 districts are provided medical care in facilities of the Social Security Board.	mck,mcd	1	3 *also finances sickness, maternity benefits and public hospitals*	1
	Large establishments have their own facilities	mck			
Philippines	Employed persons, including Filipino seafarers, qualified self-employed with P 1,800 or more a year; farmers and fishermen with P 1,500 or more a month; pensioners and dependents of employees *Exclusion: family labour, domestics, earning P 3,000 or more a month*	mck mck mck mck	1.25 2.5 2.5 none	1.25 *financed from contributions*	any deficit
	Special scheme for former government employees	mck	2.5	none	none

(Continued on next page)

Table V.14. *(continued)*

	Coverage	Benefits	Contributions[a]		
	as defined in legislation, including specified exclusions and exemptions	*see codes in notes*	*Employee (% of earnings)*	*Employer (% of payroll)*	*Government (% of payroll)*
Thailand	Establishments with 20+ employees, maximum earnings: B 500 a day; voluntary for self-employed *Exclusions: employees in agriculture, fishing, public and domestic service, railroad, shipping, telecommuniations, power generation and distribution, fuel oil production and refining, private education*	mck,mcc mcd	1.5 *also finances invalidity, survivors, sickness, maternity*	1.5	1.5
Republic of Korea	Employees in establishments with 5+ employees employees of small businesses, self-employed farmers and fishermen, through insurance societies	mck,mcc mcd,dc	3 to 8[d]	3 to 8[d]	*as employer* administration
	Employees of government and private schools covered by Medical Insurance Corporation	mck,mcc, mcd,dc	none	government	*as employer* administration
	National Federation of Medical Insurance Societies covers expensive services and technologies		financed by insurance societies *according to ability to pay*		

Sources: J.R. Marzolf, "National health insurance schemes: comparison of the Indonesian JPKM strategy with selected countries", paper presented at the Workshop on Social Security, Kuala Lumpur, January 1994; International Labour Office, "Technical note on social protection in the Republic of the Maldives" (Bangkok, ILO Regional Office, 1994); Un-Hang Shin and Jae Sung Min, "Introduction and extension of the National Pension Scheme: The Korean Experience" (ISSA/ASIA/RM/92/2 – Korea) (Manila, International Social Security Association, June 1992); H.B. Inductivo and F.E. Villaruz, "National strategies for the extension of social security to the entire population" (ISSA/ASIA/RM/2/92 – Philippines) (Manila, 1992); see the source notes in table V.4.

Notes: mcc = cash benefit for medical care; mck = medical care in-kind (treatment in clinic or hospital, medicine, artificial limb etc.); mcf = free medical care in public clinics and hospitals; mcd = medical care is provided to dependents; dc = cash payment to survivors (e.g. funeral grant).

[a] Contributions may also finance other benefits as indicated. The rate of contribution is a statutory requirement.
[b] Government also pays contributions for first five employees in small industrial and technical workshops.
[c] National Health Insurance in Japan: 1991 average contribution per household was 154,513 yen as national health tax or premium.
[d] Republic of Korea: self-employed based on assets, income and number of dependents; 1990 industrial average = 3.19 per cent.

The Government in China is encouraging local experiments in the financing of health care through pooling among enterprises, with the objective of offsetting the disadvantage of each enterprise having to bear the costs of its own scheme, and of containing costs.[25] The labour insurance covers permanent employees of state-owned enterprises which manage their own medical benefits from a Welfare Fund for Workers and Employees. Since enterprises are now financially independent from the State, employees are encouraged to participate in a variety of medical insurance schemes, such as hospitalization insurance and serious disease insurance. High-risk medical insurance is available based on compensation for part of the hospitalization costs. Insurance schemes also support immunization of children, prenatal care, and maternity and infant care. While people in rural areas are experimenting with various forms of local health insurance, national efforts are underway to establish a medical network to support the installation of a collective system in rural areas by the year 2000.

[25] International Labour Office, "Report to the Government of the People's Republic of China on social security reform" (Geneva, 1993).

Table V.15. Medical care with social insurance as employer liability

	Coverage	Benefits	Contributions[a]		
	as defined in legislation, including specified exclusions and exemptions	*see codes in notes*	*Employee (% of earnings)*	*Employer (% of payroll)*	*Government (% of payroll)*
Armenia[b] **Azerbaijan**[b] **Kazakhstan**[b] **Kyrgyzstan** **Tajikistan**[b] **Turkmenistan**[b] **Uzbekistan**[b]	All residents Employees of state enterprises and farms, and cooperatives Self-employed Enterprises, state farms, universities and collectives may provide medical facilities and personnel	mcf mck,mcc mck,mcc mck,mcd	 1 *finances all other benefits* 27 none	 12.1 to 26 entire cost	subsidies and public health care
China	Employees of state enterprises (permanent, contract and retired employees) Employers also may provide clinics and hospitals	mck,mcf mcd	none	entire cost	public clinics, hospitals
Indonesia	Managed Health Care Insurance (JPKM) regulates: Compulsory health insurance for civil servants; Workmen's Compensation insurance with ASTEK direct liability of smaller employers; voluntary scheme (PKTK) with ASTEK for private sector employees; and voluntary schemes for village organizations (Dana Sehat)	benefits vary by scheme		contributions vary by scheme	*as employer administration*
Pakistan	Provincial Social Security scheme covers firms with 10+ employees in selected industries, domestics *Exclusions: family labour, self-employed, earning above PRs 3,000 a month*	mck,mcc mcd,dc mcf	none *also finances work injury, medical facilities*	7	none

Sources: J.R. Marzolf, "National health insurance schemes: comparison of the Indonesian JPKM strategy with selected countries", paper presented at the Workshop on Social Security, Kuala Lumpur, January 1994; see the source notes in table V.4.

Notes: mcc = cash benefit for medical care; mck = medical care in-kind (treatment in clinic or hospital, medicine, artificial limb etc.); mcf = free medical care in public clinics and hospitals; mcd = medical care is provided to dependents; dc = cash payment to survivors (e.g. funeral grant).

[a] Contributions may also finance other benefits as indicated. The rate of contribution is a statutory requirement.

[b] 1990 amendments only. Information about later changes for these contingencies is not yet available.

Fiji, Malaysia and Pakistan are considering the introduction of national health insurance schemes.[26] In this context, Malaysia proposes to establish a national health security fund and Pakistan plans to establish a social security foundation. The report of the task force on social security established by the Government of Pakistan in 1994 points out the variations in health care and cash benefits under the present health insurance scheme at the provincial level. With a view to achieving uniform health care and to ensuring medical care to family members, it recommends the establishment of a social security foundation at the national level and the expansion of coverage to the entire rural and urban populations, including agricultural employees and the self-employed, by the year 2010.

Social assistance for medical care is available to all residents in Australia and New Zealand. Medical care for the elderly in Japan is financed from national health insurance schemes but may be supplemented by contributions from the state, municipalities and prefectures. In the Republic of

[26] A. Ron and others, *Health Insurance in Developing Countries: The Social Security Approach* (Geneva, International Labour Office, 1990) pp. 155-162. M. Cichon, "Health insurance in Fiji: recent developments and future options" (Geneva, International Labour Office, May 1989).

Korea, thirty-two million persons or 7.3 per cent of the indigent and low-income population are covered under the medical aid or medical assistance for the poor that operates as a social assistance scheme.[27] In India, tax financed medical care has some unique features with specific taxes earmarked for care provided to specific groups. Thus, the *Beedi* (indigenous cigarettes) Workers Welfare Fund is a national fund, financed from taxes on the sale of *beedi*. Under separate acts, employees in coal, limestone and dolomite, mica, iron, manganese and chrome ore mines and the cine industry have separate medical care provisions, financed by special levies on respective categories of production. The Coal Miners Welfare Scheme furnishes comprehensive medical care to employees in more than 60 hospitals owned by the Coal Corporation. States in India establish tax-financed funds for special categories of poor self-employed workers to support medical care and various other benefits. As emergency assistance for the medical care of migrant workers, the Government of the Philippines operates a welfare fund financed by agencies that contract for overseas employment.

FAMILY ALLOWANCES AND SUPPORT

The dominant reason for providing family allowances, as it evolved in industrialized countries, has been to help employed people to cope with the extra costs involved in supporting children. Such allowances are paid in many countries through the insurance systems or as social assistance. In very few countries in the ESCAP region does social security legislation provide for family allowances, although in many countries some support is offered under other arrangements.

Most Australians with dependent children are eligible to receive family allowances financed entirely from general revenues. Emphasis has been placed on low income families through the provision of supplementary family payments. Since 1942, Australia has provided income support in one form or another to sole parents who bring up children alone without requiring them to participate in economic activity. The Government has recently begun to assist sole parents to gain access to other sources of income, particularly for non-custodial parents. The Jobs, Education and Training Programmes have been recently introduced to promote economic activity among sole parents.

In Japan, family allowances are financed through social insurance by employers (70 per cent) and the Government (30 per cent), with no contributions from employees. Also residents with two or more children under 18 years of age, including at least one child under four years, qualify for allowances from a social assistance scheme. A law was enacted in 1992, to be implemented in all establishments in 1995, requiring employers to allow one year of leave to any new mother or father who requests it.

In New Zealand, family allowances are financed from general revenues. In addition, sole parents unable to undertake employment are eligible for the Domestic Purposes benefit, a tax-funded pension that is based on the number of dependent children.

The Central Asian republics which had extensive provisions for family allowances previously are reviewing these social insurance benefits as part of their market-oriented economic reforms. Under the Employment Fund of Kyrgyzstan, for example, food security for the family was a major component of social security provision. In 1992, the family and child allowances formed nearly half of the expenditures for the Kyrgyzstan Pension Fund. Allowances for children between the ages of 18 months and 16 years, including a birth grant for non-working parents, were available. Local governments supported children in children's homes. In early 1993, benefit levels were reduced, eligibility criteria were redefined and allowances became linked to the minimum wage. In Uzbekistan, pregnant women from low-income families receive free nutritious food, and those with medical problems receive medicines without charge. Provision of free food to students was extended since independence from primary to secondary schools. Mothers with four or more children and no employment history were given pension rights. Pensioners, families with many children, invalids, and war veterans are entitled to discounts on public services and utilities. The Government also provides subsidies for rent and higher education.

A new law for the provision of family allowances was introduced in Mongolia in 1991 to provide social assistance to the elderly, disabled and families with young children.

Most countries in the ESCAP region provide limited social assistance to vulnerable groups such as the orphans, the disabled, and the indigent elderly and widows. In the Islamic Republic of Iran, a family allowance is payable for each of the first

27 Oh-Young Park, op. cit..

two children under 18 years. A marriage grant equivalent to one month's average wage or salary is separately paid to spouses. These are financed with an employment-related social insurance scheme, the cost of which is borne by employers. The Government provides free food for students up to university level. In China those who have no family to turn to or are affected by widespread calamities, are provided with food, clothing, housing, medical care and burial through the Five Guarantees scheme. Social welfare services, available in centres in townships and cities, include homes for the aged, the orphaned, and the mentally retarded; rehabilitation for the disabled; and shelter for wanderers and street beggars. Comprehensive community services are organized for child care, nursing of the disabled, day care for the elderly, domestic help and free food at lunch for primary schools.

Social assistance helps those who are unable to support themselves in Hong Kong and the Republic of Korea. Allowances in Hong Kong are means-tested in respect of income and savings. The physically and mentally handicapped children and youngsters under 18, and pregnant women in similar circumstances receive benefits in the Republic of Korea. Benefits are cash and in kind such as food, free tuition for primary and secondary education, and medical care. The Mother-Child Act of 1989 and the Day Care Act for Babies and Infants enacted in 1991 in the Republic of Korea provide nursery schools to pre-school children under six years of age.

UNEMPLOYMENT

The major social security concern in unemployment is compensation for income loss resulting from involuntary unemployment. Public policy may establish compulsory social insurance, or through enabling legislation support voluntary agreements between employers and employees to provide for insurance coverage and attendant benefits in case of unemployment. Social assistance with or without means tests can also be used to provide income security. Unemployment benefits can support training or retraining of workers to acquire new skills for alternative employment, but may also encourage employees to stay on for reabsorption into the same employment, thus saving employers the loss of their trained, skilled and experienced workers when the need arises. Very few developing countries in the region, however, have social security schemes with provisions for the contingency of unemployment. Some developing countries offer only severance pay or gratuities, unlike most industrialized countries which offer compensation or social assistance during unemployment.

Under the Employment of Labour Act of 1965, employees in shops, and commercial and industrial establishments in Bangladesh are covered by an employer-liability scheme for compensation on termination, retrenchment and layoffs. Besides a lump-sum payment of fourteen days' wages for each year of service, most employees are entitled to an additional payment depending on their status.

The Payment of Gratuity Act of 1972 in India supports a severance indemnity. It pays fifteen days' wages per year of services on termination of employment. The Industrial Disputes Act also requires compensation to workers who are retrenched because of closure of the establishment or reduction in the work force. Payment is at the rate of 15 days' wages for each year of employment. As part of the recent economic reforms, India has been modernizing its labour laws to allow the suitable exit of labour from establishments where they are redundant. At the same time a National Renewal Fund has been established for training and redeployment of workers adversely affected by industrial restructuring. In Pakistan also, severance gratuity of twenty days' wages per year of service is payable at the termination of employment to persons in establishments having twenty or more employees. Under the payments of Gratuity Act in Sri Lanka, all employees in private sector establishments and state-sector enterprises and corporations, who have accumulated five years of service are entitled to the payment of a gratuity on the termination of services.

The Islamic Republic of Iran introduced in 1987 a social insurance scheme for unemployment for persons covered under social security legislation. It is financed by an employer contribution of 3 per cent of payroll with the Government making up any deficits. This scheme offers minimum wage benefits for up to 12 months to a single person. Benefits are extended to 24 months for those with dependents, allowing a 20 per cent increase for each dependent up to a total of four. A special insurance scheme covers the periodic unemployment of construction workers.

Under the unemployment insurance system, China initiated unemployment compensation for temporary loss of employment as part of the 1986 reforms of the labour system. It is financed by a 1 per cent contribution of the standard wage by employees and by government subsidies. These schemes support unemployment benefits of 120 to 150 per cent of the social benefit. The variation reflects the length of unemployment and the loss of in-kind benefits, such as food, housing, and other services. Unemployment benefits are payable for one or two years, depending on the length of service. The system covers employees in state-run enterprises who are unemployed because of company bankruptcy or reorganization, expiration of work contract, or dismissal. It does not, however, embrace all collectively owned enterprises, or joint ventures, townships and village enterprises, private enterprises, the self-employed and individual employees.[28]

The Employment Fund, introduced in Mongolia in April 1991, provides for a three-month severance cash payment, and insurance benefits for a maximum of 9 months generally at 50 per cent of recent wages but not lower than the minimum wage. It covers employees of all institutions and enterprises requiring contributions of 1 per cent of wages. These are supplemented by voluntary contributions and subsidies from local governments. The Employment Fund is utilized for the payment of unemployment allowances, as well as for the organization and funding of training and retraining, financing municipal public works programmes, and elaboration and realization of employment programmes (job counselling and testing, and other placement services).

Some of the Central Asian republics recently introduced unemployment insurance schemes financed by contributions from employers of a certain percentage of payroll, and government subsidies as needed. For example, in March 1992, Turkmenistan adopted an Employment Law under which employers are obliged to pay unemployment benefits for three months, to provide training and to rehire workers. An Employment Fund is financed by employers with a 1 per cent payroll tax. Benefits are paid at minimum wage rates during the first three months; thereafter, they are paid at 50 per cent of previous wages, but not less than the minimum wage, for an additional six months.

In Uzbekistan, an Employment Fund was established in 1992 to provide employment placement, retraining and unemployment benefits. It is financed by a deduction of 3 per cent of the wage bill of enterprises and by transfers from national and local governments. A major portion of its resources is used to set up small enterprises or to provide grants and loans to enterprises to maintain employment, rather than as unemployment benefits.

Unemployment insurance in Japan is based on tripartite financing. Contributions rates are: employees 0.55 per cent of wages (0.65 per cent for seasonal and construction workers), and employers 0.9 per cent of payroll (1.0 and 1.1 per cent for seasonal and construction workers respectively), with government subsidies. Compensations are normally between 60 and 80 per cent of wages, but a higher percentage for low income earners may be paid. Additional allowances support the unemployed in depressed industries. Voluntary coverage is available for employees in agriculture, forestry and fisheries.

In Australia, an unemployment scheme was first introduced in 1945 with the intention of providing short-term income maintenance as social assistance. Australia offers means-tested unemployment benefits to residents capable and willing to undertake work but who are unemployed not because of a voluntary act, misconduct, labour dispute, or refusal of a suitable employment offer. These benefits are also payable to those who were not previously gainfully occupied and who meet qualifying conditions. A strategy was introduced in February 1989 to assist and encourage the return to employment of long-term beneficiaries of the unemployment scheme by limiting benefits only for a certain duration. Income-tested benefits in New Zealand are payable up to 26 weeks to those with low annual income and 12 months of residence when unemployment is not caused by voluntary leaving, misconduct, involvement in an industrial dispute or refusal of a suitable offer.

POLICY CONCERNS AND OPTIONS

Expanded coverage

The review in the preceding sections has shown that, at the present time, the conventional social security schemes cater mainly to those who are employed in the organized sectors of economic activities mostly in urban areas. Coverage is most often limited to employees in the public sector or in large establishments and to select groups for whom

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[28] Tang Zhi Min, "Loss making and over-employment in Chinese industrial state-owned enterprises", unpublished paper (December 1994).

administration is easier and less costly. Although conventions adopted at the beginning of this century had focused on the protection of agricultural workers, except in the Central Asian republics and partial coverage for some contingencies in some of the other developing countries, those workers are mostly excluded. Domestic servants were also the focus of early conventions. Yet, along with casual or seasonal employees and family workers, they remain excluded from most schemes. The self-employed in urban and rural areas also remain generally excluded. Only a small portion of a population is thus covered for the contingencies that have been identified as minimum standards.

Even those covered are not adequately protected. The cash benefits in many schemes are insufficient to fulfil contingency needs, and they are not protected against the erosion of values by inflation. For example, the benefit provision of workmen's compensation schemes in many countries of the ESCAP region has not been updated for decades.[29]

Where laws cover and provide for certain contingencies, implementation often falls short of legislative intent. Compliance with legislative mandates is a major concern throughout the region. Employees may be reluctant to forgo income as a contribution to savings while employers often fail to collect or pay contributions.[30] While it is much easier to collect contributions from a single large employer such as the Government, compliance in the private sector among innumerable employers is a much more difficult task. For example, following a mission to Nepal by the International Labour Office and the United Nations Development Programme, it was reported that an estimated 75 per cent of employers, required to do so under the Factory and Factory Workers Act of 1959, had not established provident funds.[31]

[29] M. Jenkins, "Problems and issues related to extending social security protection to the entire population" (ISSA/ASIA/RM/92/1) (International Social Security Association, Manila, June 1992), p. 9.

[30] L.D.S. Yee, "Problems and issues encountered by provident fund schemes in Asia and the Pacific" (ISSA/ASIA/RTC/KL/VII) (Kuala Lumpur, International Social Security Association, May 1991), p. 7.

[31] International Labour Office, "Report to the government on social security planning and administration: Nepal" (NEP/85/026/1) (Geneva, 1992), p. 7.

Studies also reveal widespread non-compliance by employers on their obligations to make contributions to social insurance schemes with joint financing by employees. Non-compliance in the Social Security System in the Philippines, for example, results in delays or denials of applications for benefits and loans by employees in the private sector.[32] As a result of greater compliance, government employees take advantage of benefits more readily than is possible for employees in the private sector. Medical benefit, for example, is received by less than 5 per cent of those covered in the private sector, in contrast to more than a third of the government employees.

Recent legislative initiatives in some countries for the prosecution of employers for failing to make contributions and for the introduction of penalties for late payments promise to remedy this situation. In 1992 Malaysia introduced a policy of prosecuting all employers who fail to pay their contributions and of imposing a penalty for late payment of contributions by employers. Indonesia also adopted legislation in 1993 requiring the registration of Employee Provident Funds and Financial Institution Pension Funds for periodic review of their solvency and operations by the Ministry of Finance.

Partial coverage and continued failure to extend protection to a substantial portion of the population introduces distortions and exacerbates inequities. Coverage of employees in industry and exclusion of those in agriculture contributes to inequities between urban and rural areas. Within urban areas, small enterprises particularly in informal sectors, are excluded. In consequence, those without coverage are usually the ones who are more exposed to risks and uncertainty.

The segments of the population without coverage frequently are the most resource poor and are, almost by definition, in greater need for protection against vulnerability. In the absence of social security coverage of any form for them, they are forced to depend on the family unit to meet the contingencies which can totally exhaust whatever assets they may possess and lead to indebtedness, thereby mortgaging even their future. For example, a catastrophic illness or premature death in the family can drain financial resources and assets,

[32] E.A. Tan and E. Jovero, "Economic restructuring and non-wage income", unpublished paper (December 1994), p. 18.

increase indebtedness and weaken the economic stability of the family, setting off a poverty spiral. A weakening of the economic foundation of the family through the loss of productive assets, employment, work capacity and income also weakens the morale and the sense of solidarity in the family. Family breakdown and destitution, especially of women and children, are very often the end result.

It is recognized that supplemental government policies, programmes and actions, have targeted population groups, especially in rural areas, who have generally been left out of any conventional social security schemes. The objective has been to relieve acute distress as well as to promote economic and social development generally. Most of these measures have targeted employment promotion in public works programmes and provided basic food in lieu of work, thereby meeting both employment and food needs of families. Promotion of self-help and self-employment through public assistance and very often through the provision of loans and credits has been a common feature of efforts in the region to relieve the burden of unemployment and associated difficulties. Nevertheless, how to overcome the distress of the vulnerable groups of populations by extending social security coverage in some form remains a major policy concern in the region.

Choice of financing method

The four basic methods available to finance social security, namely, provident funds, social insurance, employer liability and social assistance, have their advantages and disadvantages in terms of specific features, scope and uses. Compulsory national provident funds usually provide for gratuity or pensions on retirement, or in case of invalidity or death prior to retirement. Compulsory national provident funds have the advantage that they force individual and family savings and place the responsibility for financial preparation for old age with individuals themselves. It can thus avoid the necessity of either increasingly higher rates of contributions under a pay-as-you-go social insurance method of financing or of long periods of contributions in fully funded schemes from which no benefits are paid during that period. The provident fund has the further advantage of being withdrawable in part or in full for financing housing, business initiatives or other needs of members. Insurance cover can also be taken out for certain purposes, such as is provided under the Medishield scheme of Singapore's Central Provident Fund. It also provides Governments with access to substantial resources for development. Because of these advantages, provident funds continue to be used in the developing countries of the ESCAP region.[33]

The disadvantage of a provident fund is that there is no pooling of risks as under social insurance and the usual lump-sum payments from provident fund accumulations do not guarantee a periodic payment throughout the length of the contingency. While they increasingly allow members to transform lump sums into annuities (pensions) upon retirement, this lump-sum benefit can be easily frittered away, exhausted or eroded by inflation, leaving members in a quandary.

Employer liability schemes are relatively simple and a faster method of introducing benefits for relevant contingencies. However, employers may find it costly and to their disadvantage in a competitive business world, depending on the differing incidence of the liability across business sectors internally and internationally. There has been a reluctance of employers generally to employ, for example, women, especially married women, which potentially carry the liability for maternity. From the perspective of employees, cash benefits under employer liability schemes are frequently inadequate to cover costs, and rehabilitation needs are rarely met under these schemes. Very often employer liability is difficult to substantiate and consequently benefits fail to materialize.

Limitations of public revenue pose problems for any substantial expansion of publicly financed schemes of social assistance, whether they are universal or means tested. However, scope may exist for such expansions in view of the very limited present spending on social security in most countries. Social insurance, which can extend to cover most contingencies, enables a sharing of risks and resources among employers and employees, and is widely used throughout the world. It remains an option, although not a substitute for all other options.

Financial viability is critically important for social security schemes in any form. The long-term

[33] After nearly two – decades of discussions, the recommendation for replacing the Employees Provident Fund in Sri Lanka with an employees pension scheme was rejected by the organizations of employees in 1994. R. Dharmalingam, "Social security situation in Sri Lanka", pp. 229-244 in T.S. Sankaran and others, op. cit., p. 242.

sustainability of accumulated reserves of both provident funds and social insurance institutions is a major concern throughout the world.[34] Sound policies relating to investments of accumulated revenues are of critical importance to their viability. Also important is the design of particular programmes. For example, early withdrawals may reduce the long-term viability of provident funds.

Because they are normally financed by contributions or by taxes, an important issue in the choice of financing method for social security schemes relates to inevitable tax and financial implications. The major concern is to make sure that their level does not impose an unacceptably high burden of taxation or contributions with potential adverse economic effects, as some industrialized countries may be experiencing.[35] In those countries outgoings from insurance funds or from public coffers have rapidly escalated because of the maturing of pension systems which were established at the end of the Second World War, and the recent high unemployment rates which require higher compensation payments and reduce contributions. The decline in the contribution base was exacerbated by declining fertility and increased life expectancy.[36] These have imposed higher individual tax burdens or higher rates of social security contributions, or cutbacks in benefits. Tax burdens or contributions, in turn, have implications for incentives to save and work. They also affect wage costs and employment, and productivity and growth.

Of particular concern to financing is the relationship between the elderly and the working population. During the thirty years between 1995 and 2025, the elderly dependency ratio (population aged 60 and above by population aged 15-59) will increase significantly in the region, albeit at varying rates in different countries. This increased dependency means a declining share of the adult population will be available as contributors for financing the needs of an increasingly elderly population. This has implications for the viability of all financing techniques for fulfilling long-term contingency needs. Elderly protection now absorbs a significant share of overall social security expenditures in the ESCAP region.[37] This suggests that frequent assessments of demographic trends are essential to guide periodic adjustments in contribution rates and benefits for social insurance to ensure long-term financial stability and intergenerational equity in financing the needs of the elderly.

In this context, a particular mention should be made of the need for designing social insurance schemes to meet the contingency of old age such that they are financially self-sustaining over a long period of time, capable of withstanding major economic and demographic fluctuations.[38] Social insurance is a defined benefit model, leaving contributions to be determined as required.[39] The pooling of risks and of resources (i.e., redistribution) within any given generation is implicit in a fully-funded model for social insurance. The principle can extend to include an element of intergeneration redistribution. This permits the choice of funding methods within a wide range. On the one hand, the pay-as-you-go method leaves the elderly pensions largely dependent on the contributions of the working-age population. On the other hand, the fully funded method entails least dependence on such contributions. There are many variations in methods within this range for financing social insurance but any funding method will necessarily lead to the accumulation of reserves which could be invested to produce income to supplement contributions. This needs to be accompanied by an ongoing process of evaluation to ensure sustainability by balancing incomings and outgoings. With a rise in the elderly dependency ratio, the rates of contributions may have to be substantially adjusted upwards to meet increased payment requirements placed upon the fund to ensure its stability. Social insurance schemes need to be "acturially valued" at intervals of three to five years in order to introduce adjustments to contribution rates.[40] Another way of dealing with the problem is to extend the age of retirement to reduce demand on the pension system as several countries in the region have done.

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[34] R.P. Hagemann and others, op. cit.

[35] A. Eueby, "Social protection and economic changes: the interactions" (CTASS/1991/3), Tripartite Symposium on the Future of Social Security in Industrialized Countries (Geneva, International Labour Office, 1991), p. 7.

[36] G. Kopits, "Toward a cost-effective social security system", presented at the Leo Wildmann Symposuim on Implications of Structural Adjustment for Social Security, November 1992.

[37] International Labour Office, "The cost of social security: thirteenth international inquiry", 1984-1986 (Geneva, 1992), table 10.

[38] G. Kopits, op. cit., p. 13.

[39] S.N. Iyer, "Pension reform in developing countries" (Social Security Department, International Labour Office, May 1993), p. 4.

[40] S.N. Iyer, ibid., p.7.

Other issues

The above are only some of the issues that must be addressed in designing schemes that are affordable and viable.[41] Decisions also revolve around informed responses to such questions as: Who should be covered? How will small business employees and the self-employed majority be treated in these schemes? Should schemes for urban employees be extended to rural areas and the self-employed? What should be the role and responsibility of the Government in financing? Should government employees maintain separate protection? How will dependent spouses, children, and other dependent relatives be treated? How will the widowed, orphaned and other dependents be treated as survivors? While these questions focus on the contingency needs of old age, invalidity and survivors, different questions arise in the context of financing benefits for the other contingencies of conventional social security.

In employment injury, for example, in hazardous sectors of industry, even large employers are concerned about the extent of their possible liability, but small businesses that operate with limited capital may have an inadequate margin to assume individual liability at all. However, with social insurance techniques, employers reduce the cost of their liability and, thus, reduce their production costs which, in turn, enhances their competitive advantage. Many countries are, therefore, shifting from direct employer liability towards social insurance to cover this contingency.

Insurance contributions for the purpose may be a flat rate or a rate established according to the riskiness in the industry or accident rate of the establishment. With the flat rate, low risk industry subsidizes high-risk industry and, thereby, encourages investment in high-risk industry. In addition to good risks financing bad risks, the flat or group rate does not offer incentives for accident prevention. However, financing employment injury benefits with employer liability established according to the riskiness of the industry or to accident rates in the establishment, introduces incentives for employers to undertake actions to prevent accidents and injuries.

The funding of health care presents a major problem in developing countries today. A growing component of national health care is a private delivery system, available to those who are able to pay either directly or through commercial health insurance, coexisting with a public delivery system as well. A system of social security in health services is also evolving, allowing costs to be shared which may free Governments from bearing the full costs of publicly provided medical services. Health insurance schemes or medical insurance built into provident funds are being made available to employees with coverage generally extended to family members. Such a restructuring of health care could arrest the current trend in some countries towards private only medical care, encouraged, *inter alia*, by budget constraints faced by Governments, and "harness" the private and public medical sectors together in attaining the health development goals of the nation as under "Health for All by the Year 2000". In many developing countries of the region, a pluralistic system involving the public sector, the private sector and non-governmental organizations together with schemes of social security is, in fact, evolving.

These health insurance schemes allow for the diversion of part of government responsibility for the delivery of health care to financing arrangements with contributions from employees, employers and state subsidies, or with miscellaneous cost-sharing mechanisms. Any such national health security systems require, however, that those who are dependent on social assistance have contributions paid on their behalf to guarantee them access to health care. Thus, Governments may assume not only administrative responsibility but also may subsidize from general revenues specific groups that are unable to cover all or part of the contributions.

Another dimension of the provision of health care is that the increase in the elderly population and consequent changes in the disease structures are important factors contributing to the increase in medical costs. Efforts have been made to overcome this problem by separating out the health schemes for the elderly from the general national health insurance system. Japan has already established a separate scheme for the elderly, and the Republic of Korea is considering similar action.[42] Other cost containment measures for health insurance schemes focus on controlling the costs of medicines and on review of claims. The co-payment system is the most widely used throughout the world as a means of recovering costs.[43]

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41 E. James, *Income Security for Old-Age: Conceptual Background and Major Issues*, Policy Research Working Paper (WPS 977) (Washington, DC, The World Bank, September 1992), p. 5.

42 Oh-Young Park, op. cit., p. 7.

43 Tae-Won Park, op. cit.

Social insurance for medical care, as in the case of any other insurance, can give rise to a moral hazard by encouraging abuse. The moral hazard arises from the insulation of patients from the consequences of medical costs. Free or subsidized care may act as a disincentive for a healthy life style or for implementation of occupational safety measures by industries. Furthermore, since fee-for-service payment schemes enable costs to be passed on, "...the provider profits from the severity and duration of the illness. Not only is this medically unethical, it virtually guarantees the rapid escalation of health-care costs".[44] Introduction of user fees, such as co-payments, deductibles and co-insurance, may, however, serve as an incentive for persons to seek effective prevention or early detection, thus avoiding higher costs at a later stage of the illness. These problems notwithstanding a national health insurance system can contribute to the achievement of the desirable goals of unification of medical care services, elimination of their inequitable anomalies, and the extension of public medical care service to all or most sections of the population.

Some suggested options

As the review above has revealed, there is no standard pattern of social security coverage in this vast region and very few schemes remain pure models, many of them borrowing techniques from each other. In most cases, coverage falls short of reaching significant portions of the population. The majority of the people, especially in rural areas, rely in times of adversity mostly or entirely on the traditional extended family and community support, or on whatever broader social protection measures are in force. When family networks are extensive and financially secure, income, savings and assets are shared among family and community networks which takes the character or form of social insurance. When families are no longer capable of such self-insurance, public schemes financed through secure revenues or other reliable sources of financing are required.

With the declining capacities of families as a result of changing age structures, and the weakening of traditional family relationships, Governments increasingly need to respond to the aspirations of their populations for an improved quality of life. An expanded social security protection contributes towards this end. In addition to individuals, families, community, voluntary and religious organizations, state involvement will continue to be necessary as part of a multi-tiered approach. The fact that most countries of the region devote 1 to 3 per cent of GDP as public spending on social security benefits, compared with more than 16 per cent spent, on average, in the industrialized countries, indicates the scope as well as the desirability of its further expansion. Within limits priorities can shift, for example, from military spending to spending on social security.[45]

In the light of increased aspirations for an improved quality of life throughout the ESCAP region, continued exclusion from coverage of significant segments of the economically active population on the grounds of administrative impracticability cannot be justified for much longer.[46] Protection of family workers, to whom little or no remuneration is paid, may be difficult but there are models worthy of exploration for their adaptability to countries in the region. Exclusion of casual workers and domestic servants because they do not fit easily into the requirements of schemes for regular collections, also deserves a resolution in countries where underemployment is widespread.

Both social assistance and social insurance techniques can be expanded and they can complement each other. The social insurance principle based on sharing contributions may exclude those who are unable to pay. Payments on their behalf can be made from public funds as social assistance so that they are not excluded from benefits. Such target oriented measures, as any other, always come up against the administrative difficulties of identifying the target groups and assessing their means. As a matter of fact, the identification of potential insured persons, their registration, formulation of working plans, and the high potential cost of administration for initiating coverage of wage earners in small establishments, the self-employed, the casually employed, the farmers, the fishermen, the artisans and rural residents generally, are frequently viewed as major obstacles to any universal extension in developing countries of conventional social security schemes.

However, a multi-tiered approach could be adopted as a long-term goal for social security cover for the general population. Universal basic

44 J.R. Marzolf, op. cit.

45 C. Gillion, "Social security and social protection: reform and development in non-OECD countries", *Monthly Labour Review* (May 1994).

46 M. Jenkins, op. cit., p. 9.

assistance from a tax-financed government programme in the form of family support, minimum pension and incomes, and a guarantee of basic needs (primary health care, primary education, food security, safe drinking water), could constitute a basic tier in a multi-tiered protection system. A contributory social insurance system among employees and the self-employed, and a private voluntary initiative within a regulatory framework, could form a second and a third tier of such a multi-tiered approach. Not only from a humanitarian point of view but also as a strategy for human resources development, social security should constitute an integral part of national development strategies within consistent and cohesive policy frameworks and operational strategies. Such policies could, for example, aim at improving the informal sector's capacity to create sustainable employment consistent with social protection needs such as working conditions, occupational safety and health.[47]

The administrative difficulties for social security protection in the ESCAP region cannot be overcome without taking account of non-formal social systems that evolved from centuries of socio-cultural experience. From this perspective the role, experience, and needs of women should be particularly looked into. Rural-urban migration, the separation of work from home, and the need for women and men to earn income from economic activity away from home, render impractical the continued reliance on traditional family-based mechanisms for delivery of social protection. Since for centuries women have assumed the major responsibility for fulfilling many contingency needs, they should be actively involved in the design of the future programmes.

Throughout the ESCAP region, there is a recognition of the need for schemes which supplement and complement rather than substitute that offered by families and communities. Priority contingencies for social protection in developing countries of the region have been identified by ESCAP members in such declarations as the Decade for the Disabled and Health for All and in their ratification of Conventions on the Rights of the Child and the Elimination of All Forms of Discrimination against Women. A more intensive and extensive exchange of experiences among countries within the region on the multiplicity of approaches adopted or being experimented with under varying conditions, partially reviewed in this *Survey*, could stimulate ideas on how to involve individuals, families and community institutions along with government intervention in mechanisms of financing and administrating social security. This is particularly needed since there are doubts as to whether, and to what extent, the social security frameworks of the developed countries can, and should, be replicated elsewhere.

Multi-tiered approaches, depending on specific situations and suitability to each individual country, thus remain viable options. One option is to limit to bipartite financing of conventional schemes with contributions from employers and employees that would leave government revenues to be used for financing alternative forms of social protection for those excluded, especially the very poor.[48] Yet another alternative could utilize community organizations, trade or professional associations, and public or private carriers to provide group insurance to particular groups. Asset and accident insurance are vital for the self-employed to reduce their vulnerability. For farmers with insufficient savings, agricultural insurance covering livestock and crops would limit their vulnerability.[49] Social insurance covering the indigent, the livestock and crops of small and marginal farmers or tools of the poor self-employed in the informal sector, for example, could be organized through financial contributions from voluntary institutions, religious bodies and other charities, besides subsidies from the Government. Special taxes are an alternative method for financing social security schemes for specific groups. There are many examples of such financing in the region, and a further exploration of their scope could be made.

Information is an essential input for effective planning for social security as for anything else. National compilations of information about existing schemes are important for the formulation of strategies for future extension. Implementation of schemes is often below the intended coverage. Since legislative mandates do not ensure compliance, actual coverage with the potential should be evaluated to ascertain the shortfall of delivery. The lack of reliable data about the majority of the population in self-employment or casual or informal employment is a major factor contributing to their continued exclusion. National sample surveys, such as the household expenditure and consumption surveys, may facilitate the determination of contingency needs and eligibility categories, and the cost-effective method for delivery of benefits.

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47 These proposals were put forward in a recent International Labour Office paper. See "Social protection in Asia and the Pacific" (ILO East Asia Multidisciplinary Advisory Team, ILO, Bangkok, December 1994).

48 R.P. Hagemann and others, op. cit., p. 12.

49 United Nations Conference on Trade and Development, "Agricultural insurance in developing countries" (SDD/INS/1/Rev.1) (8 June 1994).

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