The crisis in Asia: Over-dependence on International trade or reflection of “a labour repression-led growth regime”?

(Bruno Jetin).

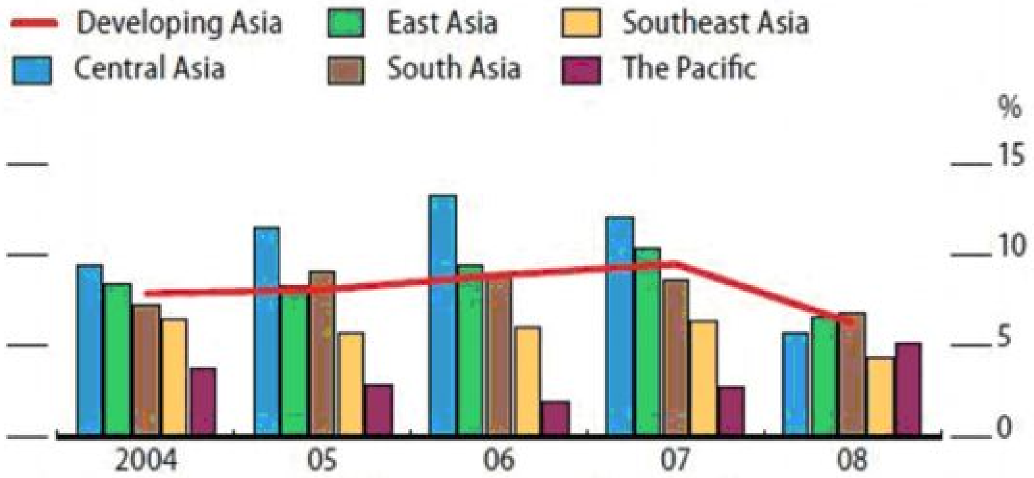
Summary

Asia has been hit by the global crisis in the last quarter of 2008. To the difference of western developed countries, the main channel of contagion was not finance but international trade. Indeed, the most affected Asian countries are the most export-dependent. In this sense the global crisis may appear as an exogenous shock on otherwise apparently successful capitalist countries, the so-called “high growth developing Asia”. In fact, with a few exceptions mostly in south Asia, the present crisis reveals a common and profound imbalance in the growth pattern of Asian countries. They all depend on either a high rate of investment and/or a high rate of export to the expense of domestic consumption. One of the most frequent explanations is that Asians save too much for precautionary reasons. In reality, the reason is a very high rate of workers’ exploitation coupled with a low level of social protection resulting in a declining labour share of national income. To some extent, the Asian case is the exact opposite of the US case. The US growth regime was unsustainable in the long-term because the main source of demand was household consumption based on extraordinary income inequalities and indebtedness. In Asia, it is the weakness of household consumption that makes the growth regime unsustainable in the long run. But paradoxically, the immediate solution in both regions points in the same direction: wage increases, reduction of social inequalities and creation of a universal social security system are unavoidable for a real rebalancing of Asia’s growth. This is particularly true for China which has turned the main carrier of growth in Asia due to its importance in Asian trade and the global supply chain. In the absence of a significant redistribution of income in China, the spectacular Asian rebound observed in the second quarter of 2009 cannot last beyond 2010, because the Chinese government cannot renew indefinitely its fiscal stimulus plan. If China sinks for good most Asian countries may capsize in its wake.

Introduction

Growth in developing Asia fell by one third from a peak of 9.5% in 2007 to 6.3% in 2008 (see Figure 1). The fall was severe for East and south East Asia and less so for South Asia, while the Pacific region registered an increasing growth.

Figure 1: GDP growth, developing Asia



Sources: Asian Development Outlook database; staff estimates.

The last economic crisis to hit the region, in 2001, was the fallout from the bursting of the dot.com bubble: regional GDP growth declined to 4.8% from 7.1% in 2000, again a one third drop. A more severe episode was the Asian crisis of 1997-98 when growth in developing Asia slowed initially from 7.5% in 1996 to 6.0% in 1997, before plummeting to 1.6% in 1998, a three quarters fall from 1996.

A closer look to quarterly data shows that most Asian countries (with the exception of Singapore and Taipei) hit the bottom in the first quarter of 2009 and that some of them have performed better during the present crisis than during the 1997-98 Asian crisis (see table 1). Moreover, available data on the first and second quarter performance of 2009 suggest that the slowdown may have bottomed out. As we will see later this is mainly due to China which on a year-on-year basis, has increased 7.9% in the second quarter of 2009 (see table 2). But two other big economies of the region, India and Indonesia have also resisted while Japan seems to have moved out of recession.

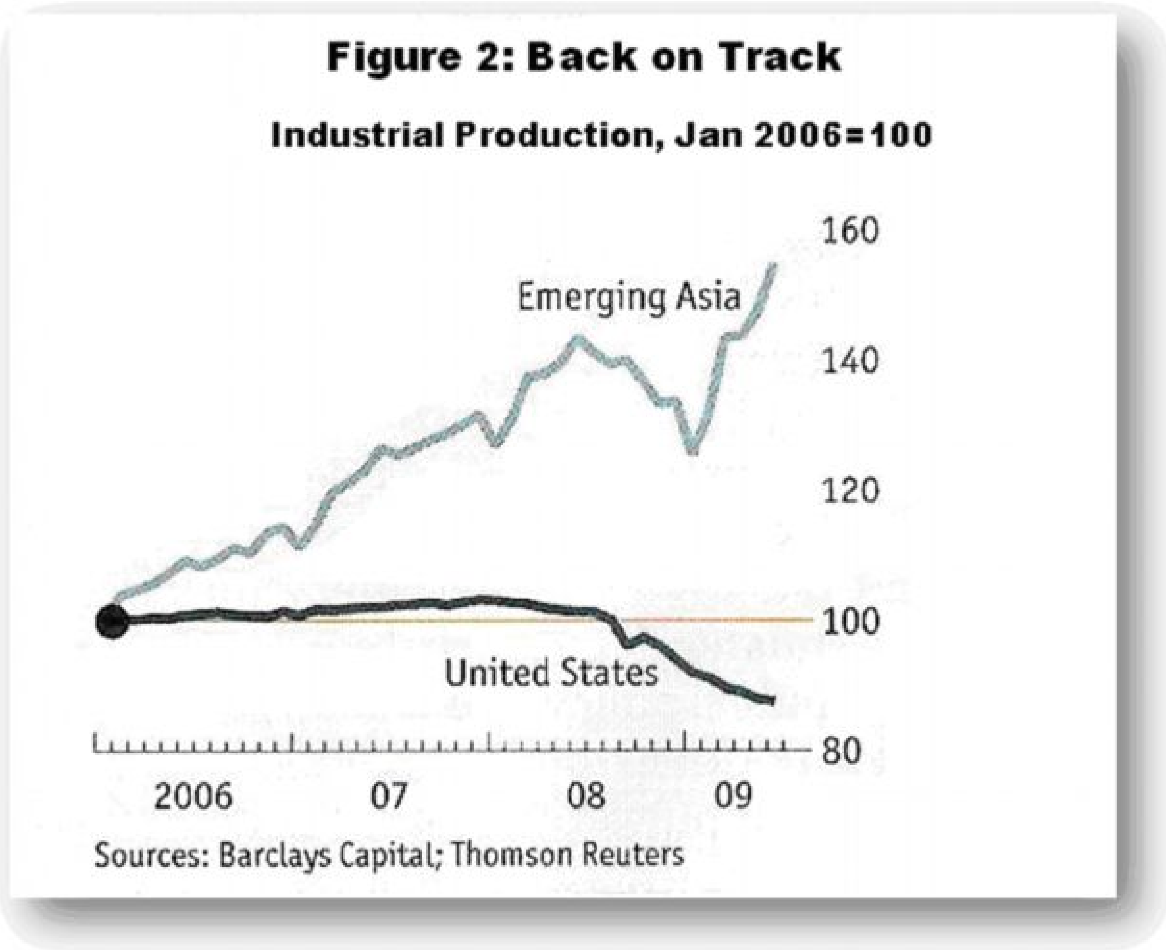
Table 1: Quarterly GDP Growth Rate—Selected Economies[1]

Country	Lowest		Latest[5]
	1997Q1—1998Q4		2009Q1
China, People's Rep. of[2]	7.20	(98Q2)	6.10
Hong Kong, China[3]	-8.06	(98Q3)	-7.79
Indonesia	-18.26	(98Q4)	4.37
Korea, Rep. of	-8.12	(98Q3)	-4.25
Malaysia[4]	-11.18	(98Q4)	-6.17
Philippines	-2.42	(98Q4)	0.45
Singapore	-4.20	(98Q3)	-9.6
Taipei,China	3.31	(98Q4)	-10.24
Thailand	-13.92	(98Q3)	-7.11

GDP = gross domestic product.
[1]Excludes Brunei Darussalam; Cambodia; Lao People's Democratic Republic; and Viet Nam for which quarterly data are not available for both crisis periods. [2]Year-on-year, year-to-date growth rate. [3]1998 growth rate based on 1993 prices. [4]1998 growth rate based on 1987 prices. [5]Based on 2000 prices.
Source: CEIC

On a quarter-on quarter basis, the recovery looks even more impressive. Comparing the second quarter of 2009 with the first, China's GDP grew by 15%, South Korea's by almost 10%, Singapore's by 21% and Indonesia's 5%. In terms of Industrial production, "emerging Asia" is the only region where, according to Barclays Capital, output has regained its level before the crisis (see figure 2). This is enough for the "Economist" to herald "Asia's astonishing rebound" (August 15th-21st 2009). Although the rebound is indeed impressive, it owes much to the recovery in China and does not give due consideration to the diversity of problems that Asian countries have to face. We have all the reason to think that it will be short-lived.

Table 2: Real GDP Growth rates, year-on-year in %						
	2008Q1	2008 Q2	2008 Q3	2008 Q4	2009 Q1	2009 Q2
PRC	10.6	10.1	9.0	6.8	6.1	7.5
Hong Kong	7.3	4.1	1.5	-2.6	-7.8	-3.8
India	8.8	7.9	7.6	5.8	6.1	
Indonesia	6.2	6.4	6.4	5.2	4.4	4.0
Japan	1.3	0.6	-0.3	-4.3	-9.7	2.3
Korea	5.8	4.8	3.8	-3.4	-4.3	-2.2
Malaysia	7.4	6.7	4.7	0.1	-6.2	-3.9
Philippines	3.9	4.2	4.6	2.9	0.6	1.5
Singapore	6.7	2.5	0.0	-4.2	-9.6	-3.5
Sri Lanka	6.2	7.0	6.3	4.3	1.5	
Taipei,China	6.2	4.6	-1.0	-8.6	-10.2	-7.5
Thailand	6.0	5.3	3.9	-4.2	-7.1	-4.9
Viet Nam	7.5	5.8	6.5	5.5	3.1	4.5
Source : Asian Development Bank, 2009						



Source: “On the rebound”, The Economist, August 15th-21st 2009.

1) A differentiated impact of the crisis on Asian countries.

The impact of the crisis on Asian countries has varied considerably. One has to discriminate for the impact on the financial sphere on the one hand and on the productive sphere on the other hand.

Impact on the financial sphere

Asia had a limited exposure to subprime assets, which initially precipitated the current crisis. Consequently, the estimated losses are minimal. Losses of total Asia, including Japan amounted to US$ 19.5 billion or 1.95% of their capital or 0.09% of their total assets to be compared with respectively 10.03% and 1.02 in the US case (see table 3). As of May 2008, total reported writedown and credit losses of the world's 100 biggest banks and securities companies amounted to US$379 billion. Of these, Asia excluding Japan accounted for US$10.8 billion, which is less than 3% of global losses.

Table 3 Asia's subprime losses

	United States	Japan	Korea, Rep. of	China, People's Rep. of	Malaysia	Total Asia
Subprime losses ($ billion)	157.7	8.7	0.4	2.8	0.1	19.5
Total bank assets ($ billion)	15,492	11,350	1,184	5,950	267	20,965
Capital of banks ($ billion)	1,572	572	85	256	29	998
Subprime losses as share of capital (%)	10.03	1.52	0.52	1.08	0.30	1.95
Subprime losses as share of assets (%)	1.02	0.08	0.04	0.05	0.03	0.09

Notes:

Capital of banks: "capital account" item in International Financial Statistics as of December 2007.

Total bank assets as of December 2007 for the United States and Malaysia; as of January 2008 for Japan, Korea, and People's Republic of China.

Total Asia includes data on other commercial banks in Asia.

Japan: Mizuho Financial Group and Nomura Holdings.

Korea, Rep. of: Woori Bank.

China, People's Rep. of: Bank of China, Commercial Bank of China, China Construction Bank.

Malaysia: 0.3% of capital base of banks.

United States: 14 banks.

Source: M. Kawai, M. Lamberte, and D.Y. Yang. 2008. "Global Shocks, Capital Flows and Asian Regional Economic Cooperation." Asian Development Bank Institute, Tokyo.

Similarly, the indirect exposure of Asian banks to US and European banks which have suffered sizeable losses is quite small. For example, the exposure of Asian banks to Lehman Brothers, has been limited (see table 4).

Table 4 Selected Asian banks with exposures to Lehman Brothers bank, September 2008

Bank name	Economy	Exposure ($ million)
Citibank (Hong Kong, China branch)	Hong Kong, China	275
Mega Financial	Taipei,China	200
Industrial and Commercial Bank of China	People's Rep. of China,	152
Banco de Oro	Philippines	134
Bank of China	People's Rep. of China	129
Bangkok Bank	Thailand	101
Bank of Nova Scotia (Singapore branch)	Singapore	93
Shin Kong Fin	Taipei,China	80
Development Bank of the Philippines	Philippines	90
Metropolitan Bank and Trust Company	Philippines	71

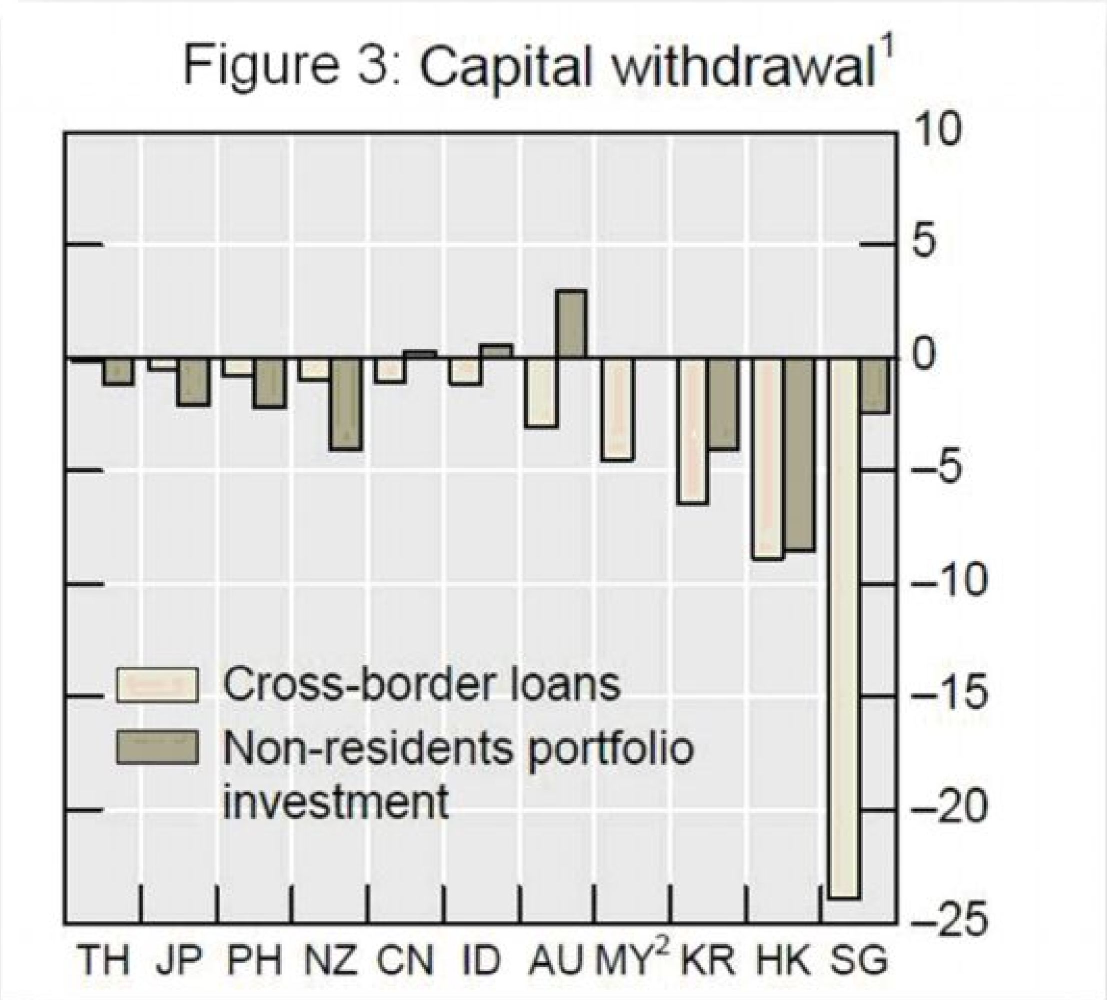
Source: Reuters, available: http://uk.reuters.com/article/governmentFilingsNews/ idUKMAN20091320080925, downloaded 26 September 2008.

For example, the Bangkok Bank has suffered a loss of US$ 101 million, which is quite a significant amount of money, but cannot put it in danger.

Even though direct or indirect exposure to the subprime losses have been minimal, the overall financial impact of the crisis in Asia has been quite significant.

The financial impact manifests itself through capital flight (see figure 3). First, by outflows of portfolio investment and subsequently by the increasing difficulty in rolling over maturing US dollar debt, especially short-term cross-border loans accorded by international banks. The drop in cross-border loans, as a percentage of GDP, was largest in the financial centres of Singapore and Hong Kong. Portfolio outflows were largest in Korea and New Zealand, which have liquid and open equity markets, and Malaysia, which has a large domestic bond market with a significant foreign participation (BIS 2009). Capital outflows had limited impact in Hong Kong, Japan and Singapore, because those economies had large external surpluses and repatriation of capital more than offset capital withdrawal. In the Japanese case, the repatriation even led to a real appreciation of the yen, reinforcing difficulties of Japanese exporters which already had to cope with fallout of their external markets.

In other countries like Korea, capital outflows had a more dramatic effect. Outflows began in third quarter of 2007 and continued throughout the crisis. In the Fall of 2008, the won had already lost 40% of its initial value. This was the largest depreciation of Asian currencies in the present crisis so far. US$ 60 billion of foreign exchange reserves had vanished. The spread on sovereign bonds which reveals the risk aversion of investors skyrocketed to 700 base points in November 2008 up from 30 points before the crisis. The Korean collapse can be explained by a set of factors



[1] Q4 2008 data for cross-border loans and 2008 annual data for non-resident portfolio investment (gross flow), both as a percentage of 2008 GDP.

[2] Data on non-resident portfolio investment not available.

Source: BIS 2009

c

ontributing to a high financial fragility: An almost complete free mobility of capital, the existence of liquid and profound capital markets, the development of derivative markets and the floating of the exchange rate. An additional important factor is the deterioration of the balance of payments since 2005. The financing of its deficit has relied even more on short-term loans subscribed by Korean banks to the expense of more stable sources of financing such as foreign direct investments and long term loans. Korean Banks' preference for short-term loans is due to the fast increase in the loans they made to domestic companies and households while deposits were increasing at a slower pace. This is exactly the contrary of the trend observed in other Asian countries. Korean Banks had to roll over their debt and because domestic savings are insufficient, they had to take short-term loans from foreign banks labelled in US$. As a consequence, the external debt has doubled between 2005 and 2008. When the crisis broke at the fall of 2008, investors became frightened of the heavy reliance on short-term foreign debt and began to withdraw their capital from Korea. "The size of financial capital withdrawn on net for just October 2008 was US$25.5 billion (more than 3% of annual GDP) which was far larger than the US$6.4 billion in December 1997, the worst month during the Asian crisis"(Cho, Dongchul 2009). By December 2008, over US$70 billion (7.7%) had been withdrawn from Korea's equity market by non-residents. Credit guarantees from the central bank proved less effective than in other countries and Korea had to use its huge foreign reserves to avoid a collapse of its currency and to provide foreign currency liquidity to domestic banks and exporters. Subsequent foreign currency swaps from the FED, China and Japan helped to restore confidence and the provision of additional liquidity. The devaluation of the currency led to an abrupt improvement of the current account which contributed to half of the recovery of the balance of payments during the first 8 months of 2009. The return of foreign investors made the other half.

Impact on the productive sphere

The recession that hit the G3 economies in 2008 has been transmitted to developing Asia primarily through the trade channel and as noted above secondarily through the financial channel.

The plunge in G3 import demand has resulted in a sharp contraction in developing Asia's export growth of around 30% for East and Southeast Asia and around 10% in South Asia (see figures 4 and 5). As a general rule, the negative impact has been stronger in countries most open to trade (see figure 6) and whose exports are the most concentrated in manufacturing and when the US are an important customer. Manufacturing exports account for more than 140% of GDP in Singapore, nearly 70% in Malaysia, more than 40% in Cambodia and Thailand and more than 30% in China, Korea, the Philippines and Vietnam. On the other hand of the spectrum, manufacturing exports make up less than 10% of GDP in India and Pakistan and only around 11% in Indonesia. These factors explain why countries like the Philippines and Indonesia have suffered less than Singapore and Malaysia for instance. Two exceptions to the rule are China and Vietnam due to their huge fiscal stimulus plan (see below). The collapse in global demand also caused investment to fall dramatically in the Newly Industrialised Countries (NIEs, Singapore, Hong Kong, Taipei, South Korea) and in ASEAN-4 (Philippines, Indonesia, Thailand, Malaysia). The NIEs were particularly hit, with investment falling 15.3% in the first quarter of 2009 (see figure 7a). ASEAN-4 economies did not suffer as badly, with investment declining 5.3% over the same period (see figure 7b). Domestic consumption was also weak, falling 2.3% in the NIEs as consumers cut back on spending, while it only slowed down in the ASEAN-4 countries to 2.6% in the first quarter of 2009 down from 5.5 in the third quarter of 2008 (ADB 2009a).

Figure 4: Export Growth[1]—NIEs
(USD value, y-o-y, %)

y-o-y = year-on-year.
[1]3-month moving average of merchandise exports.
Source: OREI staff calculations based on CEIC data.

Figure 5 : Export Growth[1]—ASEAN-4
(USD value, y-o-y, %)

Source: Figure 4 and 5 comes from "Asian Economic Monitor July 2009", Asian Development Bank.

Figure 6: Exports Share and GDP Growth—Emerging East Asia

[1]Merchandise exports.
GDP = gross domestic product.
Source: CEIC; International Monetary Fund's *Direction of Trade Statistics*, *International Financial Statistics*, and *World Economic Outlook*; Datastream.

The smaller ASEAN countries (Vietnam, Cambodia and Laos) performed better than the larger ASEAN-4 countries as they are less dependent on exports. Vietnam's economic growth slowed to 3.1% in the first quarter of 2009, the lowest level of growth in a decade. However, growth picked up in the second quarter to 4.4%. The recovery is probably not sustainable because it owes much to the big fiscal stimulus plan whose central element is an interest-rate subsidy programme worth US$ 1 billion. It will widen the budget deficit from 4.1% of GDP in 2008 to 10.3% in 2009 and it will not be easy to finance it as foreign investors are averse to risky emerging-market government debt. Cambodia's GDP grew 6.5% in 2008, lower than the 10.2% growth rate in 2007. In Laos, GDP growth rate was 7.2% in 2008 thank to continued growth in the mining and hydropower sectors.

Amid the slowdown across most of developing Asia, China (PRC) stands as a bright exception (and to a lesser extent Indonesia and India) as it continued to grow at a high rate during the first half of 2009.GDP growth had started to slow from its 14% peak in the second quarter of 2007 after the Chinese government decided to cool down the booming economy.

Figure 7a: Domestic Demand Growth—NIEs
(y-o-y, %)

Figure 7b: Domestic Demand Growth—ASEAN-4
(y-o-y, %)

y-o-y = year-on-year; NIEs = Hong Kong, China; Korea, Rep. of; Singapore; and Taipei,China; ASEAN-4 = Indonesia, Malaysia, Philippines, and Thailand.
Source: OREI staff calculations based on CEIC data.

The GDP grew at 6.1% in the first quarter of 2009 and improved in the second quarter, increasing by 7.9%, thanks to the government's massive stimulus plan which gave a strong impetus to investment offsetting the plunge in external demand which fell to a new low of 22.2% in May 2009 (see figure 8).

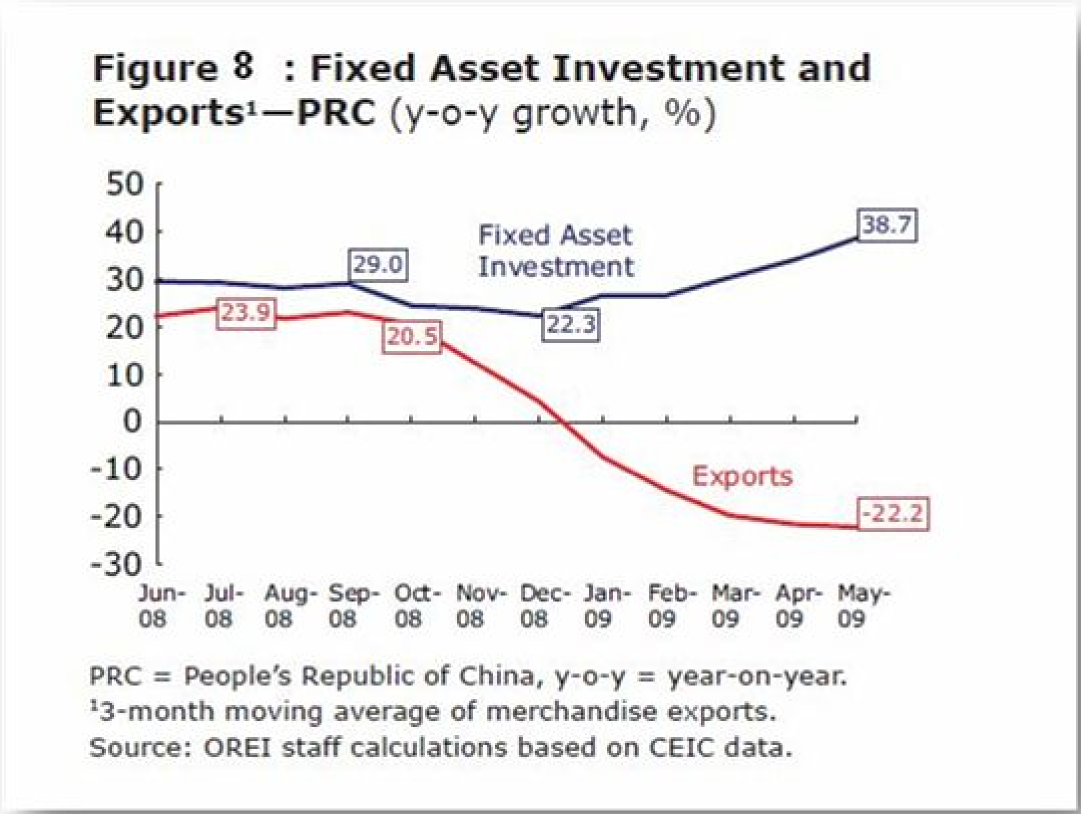


Figure 8 also reveals the extraordinary level of investment as a share of GDP and how much the fiscal plan may be effective in stimulating growth but is fragile at the same time. One cannot expect the Chinese economy to counterbalance the exports drop by a continuous increase of the level of investment on the long-term. Investments in fixed assets produce goods, which one day or another must be sold to consumers, in this case Chinese consumers as foreign consumers are defaulting. And yet, Chinese household demand is put to severe test. Not only the labour income share has been decreasing these last years but the present crisis struck a new blow to workers' income. In a way, this assessment can be extended to other Asian countries. How can Asian consumers come up to the rescue of Asian consumers in such a situation? We will develop this point further below but first it is necessary to assess the social consequences of the crisis on the population.

2) The social impact of the crisis.

Workers in the financial services industries from rich countries of the region such as Australia, New Zealand, Hong Kong, Singapore, Japan were affected from the outset due to the highly integration of their banking systems and stock exchanges with the USA. In developing Asia, workers were impacted later through mainly the export channel. Workers from the exporting industries were dismissed first and later, when the impact spread to the rest of the economy, employment in other sectors has also been hit hard.

Like in rich countries, the overall social impact of the crisis reflects in reduced working hours, downward wage pressure, and massive job losses. But in developing Asia, the crisis also means reduced remittances from migrant workers, reverse migration, shift to vulnerable and informal employment and rise in working poverty. These dramatic effects are compounded by low social coverage.

- Reduced remittances. Remittances represent a vital source of income for many poor households. They comprised one third of GDP in Tonga,11% in the Philippines, and between 5 to 10 % in Bangladesh, Sri Lanka, Viet Nam and Mongolia (Kim, Kee Beom, Huynh Phu, Sziraczki Gyorgy, and Kapsos Steven 2009).

- Downward wage pressure. Between 2001 and 2007, a period of strong economic growth in developing Asia, average annual real wages grew at a rate of 1.8 %, far below the average annual growth in labour productivity over the same period (ILO, 2008). With the overwhelming majority of countries having collective bargaining coverage of less than 15%, the crisis may lead to a stagnation of real wages or even a fall.

- Job losses. There are numerous announcements of massive dismissals in Asian countries especially in the manufacturing sector although we do not have yet a global evaluation of Job losses for the region. But we know that millions of workers working in key exports industries have been laid off, many of them being employed in small and medium enterprises which supply larger firms in national, regional or global production chains. In China alone, the government has recently stated that around 20 million internal migrant workers, i.e. more than 15% of the estimated 130 million internal migrant workers in the country, lost their jobs in recent months. Unemployment data only gives a partial view of the impact of the crisis on jobs in a region where wage labour represents a minor share of total employment[1]. But unemployment has indeed risen in countries affected by the crisis such as Japan (+26%), Korea (+18%), Singapore (+73%) and Thailand (+28.7) (Table 5).

[1] 21% in South Asia, 39% in-South East Asia and the Pacific, 43% in East Asia. In rich countries, it is 84%. ILO. 2008a. "Global Wage Report 2008 / 09. Minimum wages and collective bargaining:Towards policy coherence." *Global Wage Report*: 120. International Labour Organisation: Geneva.

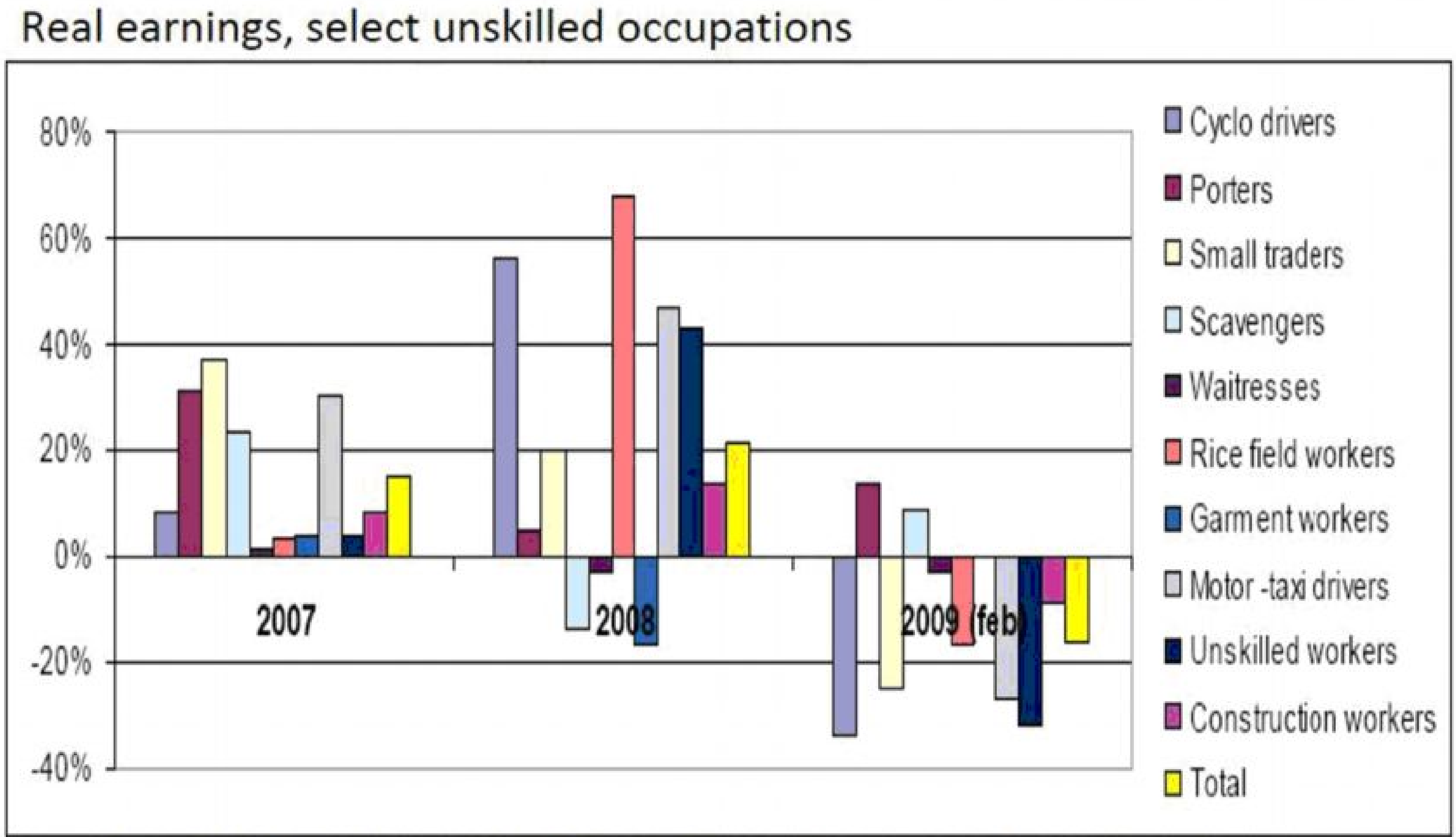
Table 5: Unemployment and number of unemployed, selected Asian countries 2008-09

	Unemployment rate, early 2008	Unemployment rate, early 2009	No. of unemployed, early 2008 (thousands)	No. of unemployed, early 2009 (thousands)	% change in no. of unemployed
Indonesia	8.5	8.1	9,430	9,260	-1.8
Japan	4.0	5.0	2,650	3,340	26.0
Korea, Rep. of	3.2	3.7	787	933	18.6
Philippines	7.4	7.7	2,675	2,855	6.7
Singapore	1.9	3.2	55	96	73.3
Thailand	1.7	2.1	606	780	28.7

Source: National statistical offices.

More relevant is the expansion of informal and vulnerable employment and the shift to the rural sector. Similar phenomena had been observed during the Asian crisis in 1997-98. Vulnerable employment can be defined as the sum of own-account workers and unpaid family workers. In Thailand for instance, the fourth quarter of 2008 figures indicates that the number of wage employees contracted by more than 100 thousand , while the number of own-account and unpaid family workers increased by an astounding 800 thousand compared to the previous year. This is a complete break from 40 years trend of decreasing numbers and share of own-account and unpaid workers. Women comprise a disproportionately large share in vulnerable employment in Asia because they are the first to be dismissed from export-oriented industries. For example, there are two to four times more women than men in garment and textiles in Philippines, Thailand and Vietnam and 5.3 times more women in electronics in Philippines. And this is just the beginning of a wider trend that will add considerable pressure on rural labour markets where job opportunities are scarce. Rural households' income will not be able to support more numerous families and poverty will increase. Globally, workers and households who have risen just barely above the poverty line in recent years due to new formal employment opportunities are now very vulnerable to falling back into poverty as a result of the crisis. "More than 52 million workers are currently living just 10% above the extreme US$ 1.25 poverty line, while more than 140 million are living just 20%above the extreme poverty line" (ILO 2009). In Cambodia, income of these categories of workers is already falling (see figure 9).In India, waste recyclers are also feeling the impact of the crisis on their income, because the prices of waste has fallen due to the recession (see figure 10).

Figure 9: Fall of income in Cambodia



Source: CDRI Vulnerable Workers Survey, in H. Jalilian et al.: "Global Financial Crisis Discussion Series Paper 4: Cambodia" (London, ODI, 2009).

Figure 10: Fall of income for recyclers in India

Prices of Waste

	Prices (Indian rupees)	
Type of Waste	**October 2008**	**January 2009**
Steel/Iron		
Nuts, bolts, screws	25	15
Waste steel	6	3
Plastic bags		
Type 1	18	6
Type 2	8	5~6
Paper		
Brown paper	3	2
Newspaper	8	4
Hard plastic		
Type 1	15	6~8
Type 2	13	3~4
Cloth		
Clean cloth	6	3
White cloth	20	12

Source: Self Employed Women's Association (SEWA), available at http://www.wiego.org/reports/SEWA-report-Waste-Recyclers.pdf

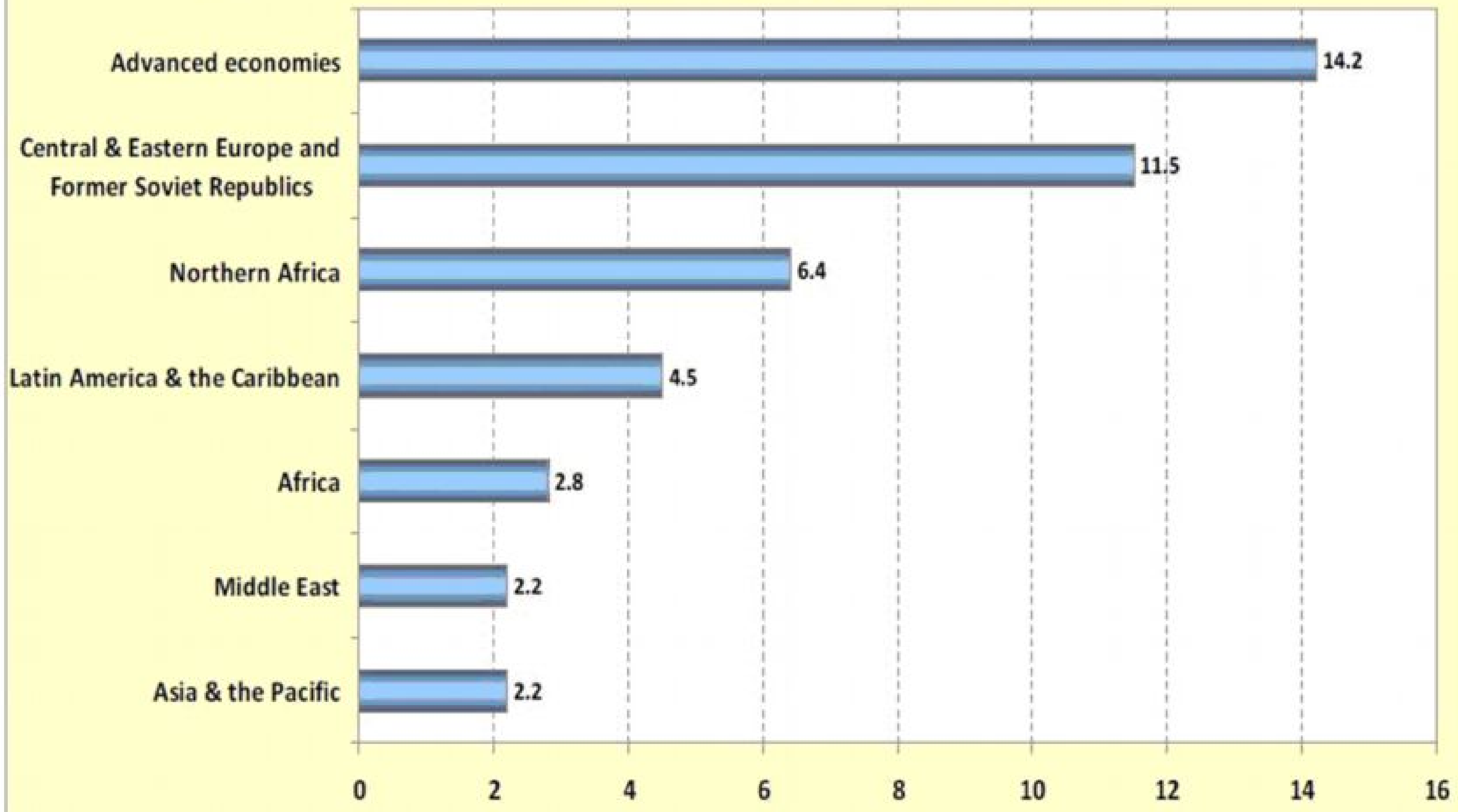
In Ahmedabad city for instance, work approximately 35,000 people recycling 12 to 14% of the 300 tons of waste dumped each day. According to the Self-Employed Women's Association (SEWA), "since the last 5 months, their incomes have decreased by at least 50%".

Youth are also likely to be disproportionately affected by the crisis. In 2008, youth in Asia were more than three times as adults to be unemployed. The figure could rise sharply as the young workers are usually the first to be dismissed. "In the Philippines, for example, the number of unemployed youth in January increased by 5.9 per cent to 1.4 million compared to the previous year. Similarly, in Japan, the year-on-year increase in the number of unemployed youth in February 2009 soared by 19.5 per cent, or an increase of 80 thousand. Moreover, in China, an estimated 6.1 million new college graduates will enter the labour market in 2009, joining the 4 million from previous years who are still seeking employment" (ILO 2009).

In summary, the ILO estimates "that the number of unemployed workers in Asia and the Pacific rose by 4.4 million in 2008, to 90.3 million, or to 4.8% of the labour force(ILO 2009). Given the crisis, the ILO projects that the number of unemployed in Asia, compared to 2007, would increase by a range of between 9 million to 26 million, with a corresponding unemployment rate of between 5.0% and 5.9% in 2009. The pessimist scenario, the more probable, would be represents an unprecedented increase in the region as a whole. Furthermore, the ILO estimates that 1.09 billion workers, 60.7% of all workers in the region, were classified as being in vulnerable employment in 2008. In 2009, if the economic situation continues to deteriorate, the number of male and female workers in vulnerable employment in Asia could grow by an alarming 64 million, an increase of 6%. Economic shocks impact less on the number of jobs as opposed to the overall quality of employment" (Kim, Kee Beom, Huynh Phu, Sziraczki Gyorgy, and Kapsos Steven 2009).

The social consequences for many of the region's workers and family could be dire because social expenditure as a share of GDP is only 2.2 % in the Asia-Pacific region, which lags behind other regions in the world, such as Latin America and the Caribbean (4.5%) and Northern Africa (6.4%) not to say rich countries (14.2%) (see figure 11). There are not social cushion of the crisis in Asia.

Figure 11: Social expenditure as a share of GDP (%), most recent year available



Source: ILO: *The Financial and Economic Crisis: A Decent Work Response* (Geneva, 2009), Figure 4 referencing IMF: Government Financial Statistics (2007).

3) May China be an engine of recovery?

Rebalancing growth is the new motto of official institutions in Asia. It is now commonplace to describe the global arrangement between Asian countries and the USA that prevailed before the present crisis has unsustainable: Foreign exchange reserves accumulated by Asian countries are used in part to provide the external financing required by the US to cover its current account deficit. Put in another way, the region’s export-oriented countries support sustained purchases of Asian exports by US consumers who pay for their goods not with rising incomes but with rising debts. This system allowed East and South East Asia to achieve rapid rates of economic growth with a massive shift of workers from agriculture to industry and services. Because absolute poverty is concentrated in rural areas, this structural transformation led to a fall of absolute poverty (the share of population living below the absolute poverty line) and a rise of relative poverty, i.e. the rise of income inequalities. The story varies in time and scope according countries but holds throughout the region. Fast industrialisation led to the creation of a numerous and concentrated industrial working class, suffering from dangerous, dirty and low paid jobs, still living better off than peasants, and a huge and urban middle-class better educated and taking advantage of good jobs opportunities and usually supportive of the bourgeoisie and the bureaucracy. The clear-cut opposition in Thailand between the “red shirts” made of poor peasants, industrial workers and other urban workers on one side and the “yellow shirts” mixing the Bangkok middle class, the bourgeoisie and the state bureaucracy in Thailand is a good example. But the same is true in China where the CCP is counting on the support of the middle-class to maintain a strong grip on power.

Now that US households’ demand is down for a prolonged period of time and that the US will downsize its current account deficit over an extended period of time, Asia can no longer rely on ever-larger quantities of exports of an ever-wider range of manufacturing goods to achieve high growth. This raises serious economical and political questions for the government of the region.

The high growth rate was a convenient way to avoid reducing social inequalities. Now that Asian countries enter a period of prolonged slow-growth, how to manage the political tensions that will inevitably emerge from the general discontent?

Is it possible to rebalance growth in favour of the domestic market and achieve a reasonably high growth rate?

How to stimulate domestic demand without endangering export competitiveness and making a dent in the huge profits that companies are used to harvest?

All the governing elites of the region have to face these questions, but there is one country where the answers encountered will be of the outmost importance:

China, which has turned into the single most important economic partner of numerous Asian countries, starting with Japan and Korea.

If China manages to rebalance its growth in favour of its huge domestic market, will it turn into an engine of growth for the rest of Asia?

There are no definitive answers to all these questions, but it is at least possible to make some hypotheses.

The starting point is to question the too easily accepted idea that large and systematic current account surplus are an intrinsic structural features of Asian countries. In fact, the region as a whole ran deficits until the Asian crisis of 1997-98. Until the beginning of the nineties domestic demand was indeed the main driver of growth in such diverse countries as China, India, South Korea, the Philippines and Thailand. Net exports turned positive and its contribution to growth increased in the nineties only in all the countries except the Philippines (Felipe, Jesus and Lim Joseph 2005). A broader analysis of the eleven largest Asian economies for which data is available, accounting for more than 95% of regional GDP, reinforces the earlier observation that current account surpluses are a recent phenomenon (ADB 2009b). Figure 12 depicts four broad types of current account experiences:

1. Low-income current account surplus economy like China, where the surplus were small and not systematic until 2003 when it reached the very high level of about 10% of GDP;

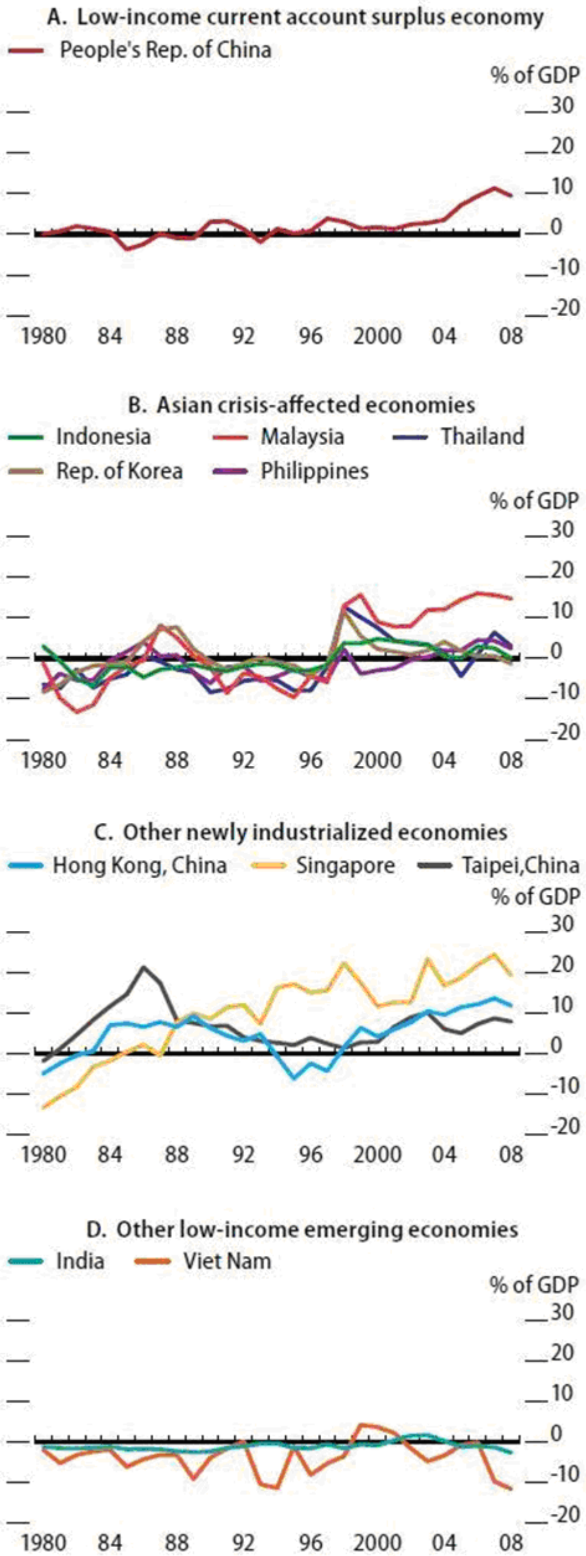
2. Asian crisis-affected economies: Indonesia, Korea, Malaysia, Philippines and Thailand. In these countries current account shifted from large surplus to deficits around the time of the Asian crisis of 1997-98, with surpluses narrowing in recent years, except in the case of Malaysia.

3. Other newly industrialised countries (NIC): Hong Kong, Singapore, Taipei. In these economies, current accounts have been in surplus for extended periods with the surpluses increasing in recent years.

4. Other low-income emerging economies: India and Viet Nam. In these countries, current accounts have on average remained in deficit.

In summary, since 2003 expanding current account surplus in Asia largely results from a surge in Chinese surplus. In Asian crisis-affected countries (except Malaysia), the surplus is rather small and come from weak investments after the Asian crisis of 1998-98 from which these countries never fully recovered. These countries have entered a slow-growth era earlier than would be expected, because with the exception of Korea, they are still middle-income countries. The three other NIC (Hong Kong, Singapore and Tapei) show also a pattern of long-term decline in their investment rate as might be expected of mature, high-income countries.

Figure 12: Asian current account imbalances



Note: 2008 data are estimates.

Source: International Monetary Fund, *World Economic Outlook* online database, October 2008.

Figure 13: Investment rates of individual Asian economies

Sources: Asian Development Bank, *Statistical Database System*; CEIC Data Company Ltd., both downloaded 10 January 2009.

Conversely, in the case of the other two low-income countries, India and Vietnam, the current account deficit reflects a secular increased in investment as also might be expected in such countries. Like in China, their investment rate now reaches around 40% of GDP.

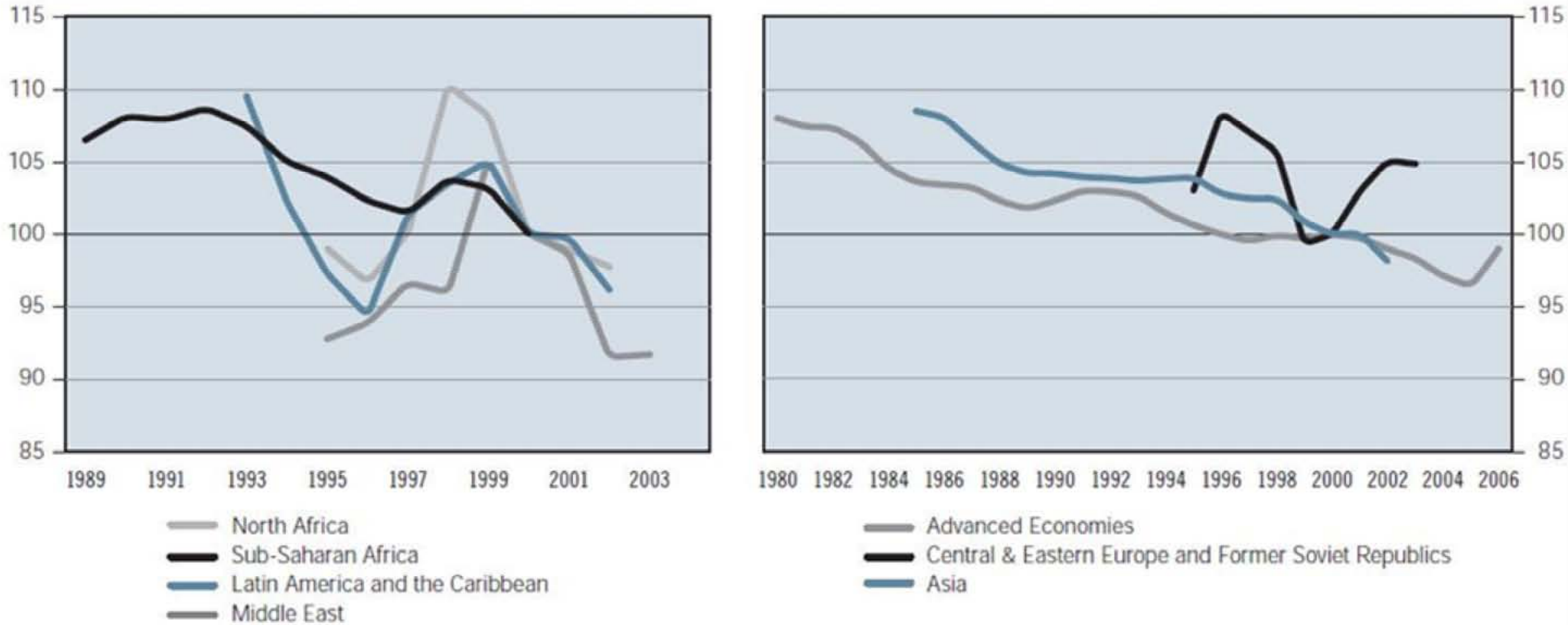
But China remains a unique case in the sense that it combines a very high investment rate, more than 40%of GDP and a high current account surplus.

Most of reports from international institutions discuss at length whether Asian countries save too much for cultural and sociological reasons or invest too little because they don't have "liberalised" enough their domestic markets; have not suppressed the remaining "barriers to free trade" in industry and services impeding productivity growth; or have not invested enough in education with skill shortages as a consequence. But they rarely take into consideration absolute or relative poverty, households' indebtedness, low wages, expensive housing, expensive costs of education, the absence or the weakness of social security. One way to understand why most Asian countries have combined current account surplus and low rate of investment (with the exception of China) is too look at the evolution of the share of labour in national income. As in other parts of the world, the labour income share in Asia has lost 9 percentage points between 1984 and 2002 in favour of the profit rate (see figure 14). It is as much as in rich countries during the years 1980-2005 but less than in Latin America where the labour income share has lost 13 percentage points in shorter period, 1993-2002 (ILO 2008b). These averages hide disparities among countries.

In China, the Labour income share has decreased from 52% in 1997 to 40% in 2007, i.e. a loss of 12 percentage points in 10 years in favour of profits which jumped from 20% to more than the 30% (see figure 15). These are the boom years when the GDP growth rate exceeded 10% and the current account registered huge surplus. As a consequence, no wonder that private consumption fell from an already low level in 1993 of 47% of GDP to an even more low level of 37% in 2007 (see figure 16). To compare, the share of private consumption in GDP in the OECD countries was 61% in 2007 and 72% in the USA in 2007, almost the double of the Chinese share.

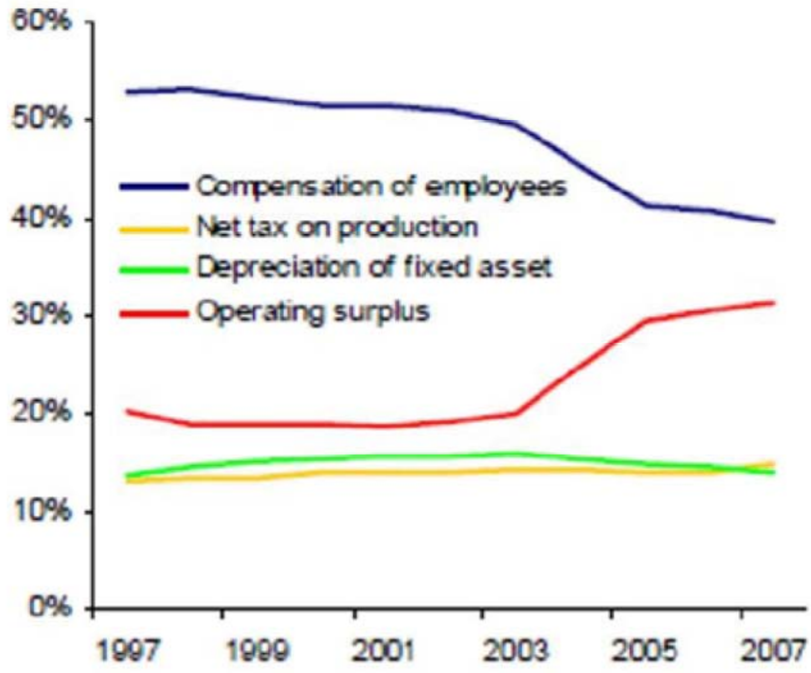
Thailand epitomises the case of the Asian crisis-affected economies where investment never fully recovered their pre-crisis level. The labour income share fell from an estimated level of 87% in 1960 to 65% in 2007 (see figure 17). Again, one can clearly see the effect on private consumption which fell from 73% to 54% in the same period. This explains why private companies were not willing to invest massively despite the return of high profits (see figure 18). As in rich countries, they would prefer to pay high dividend to shareholders, high revenues to managers, invest in financial markets or abroad.

Figure 14: Development of wage shares, by region, 1985-2006
(Wage share in 2000 = 100)



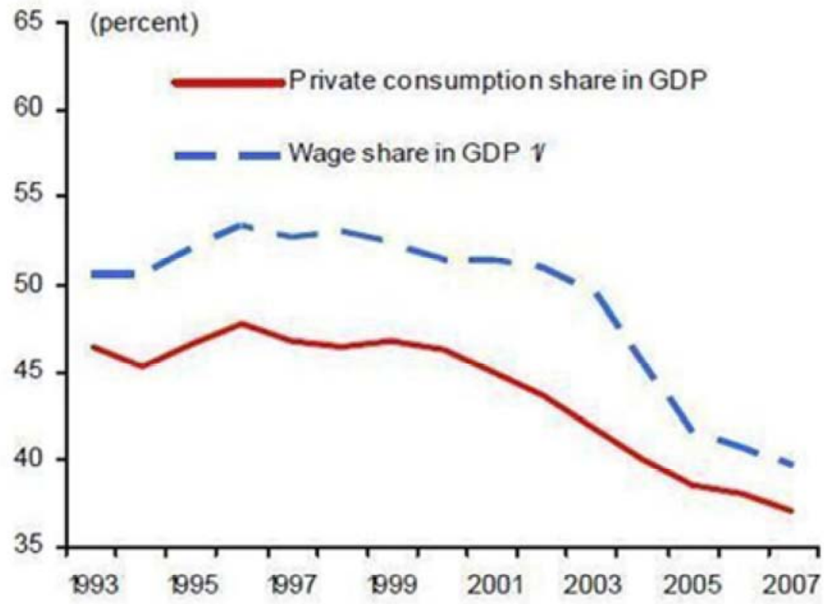
Source: "World ofWork Report:Income Inequalities in the Age of Financial Globalization", ILO, 2008

Figure 15: Evolution of Labour and Capital Income Share in China

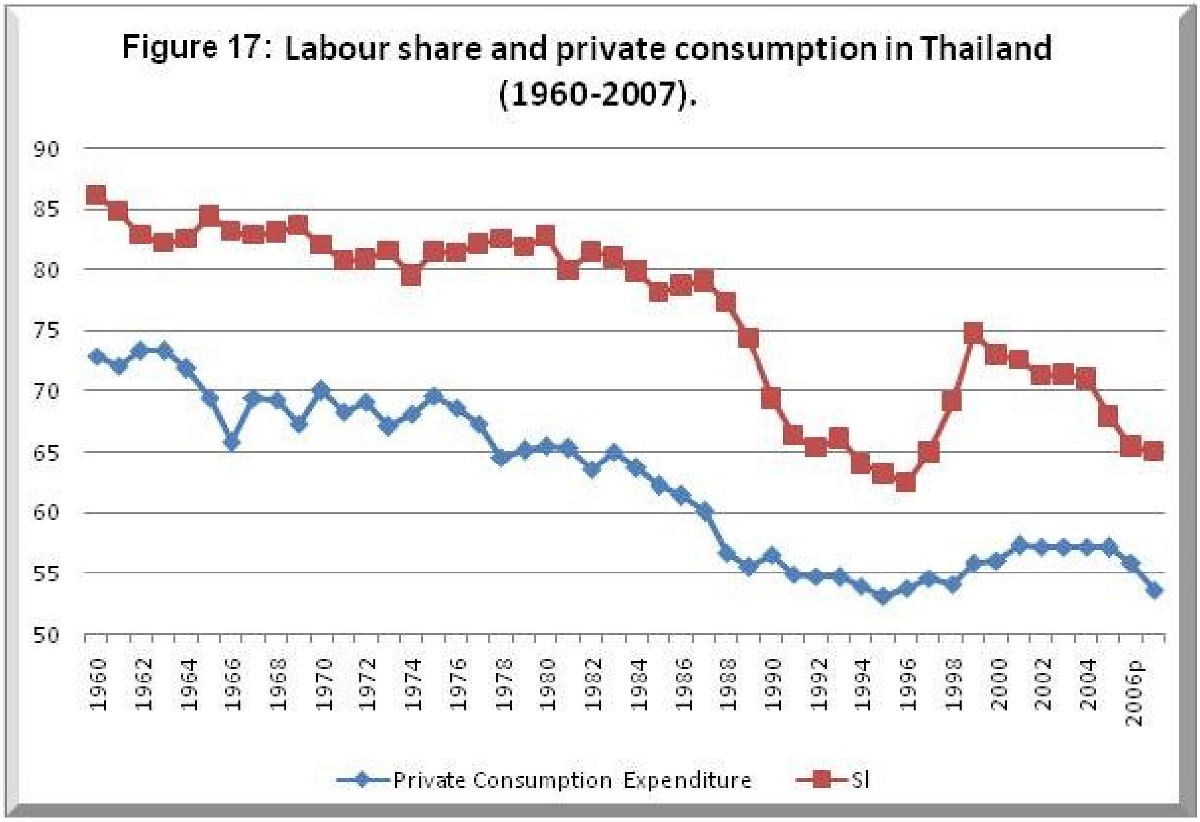


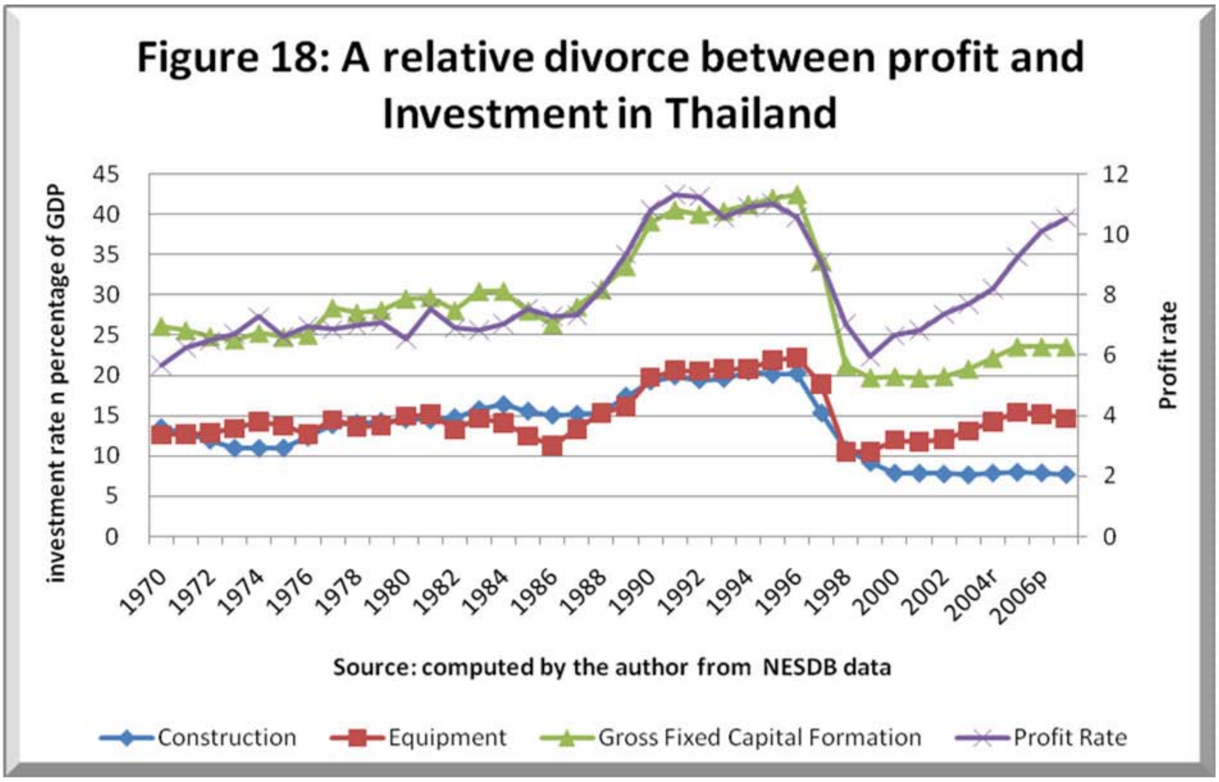
Source : CEIC, UBS (% PIB)

Figure 16: Structure of the economy is key to increasing the role of consumption



Source: NBS, staff estimates
1/ from *China Statistical Yearbook*, table 2-20.



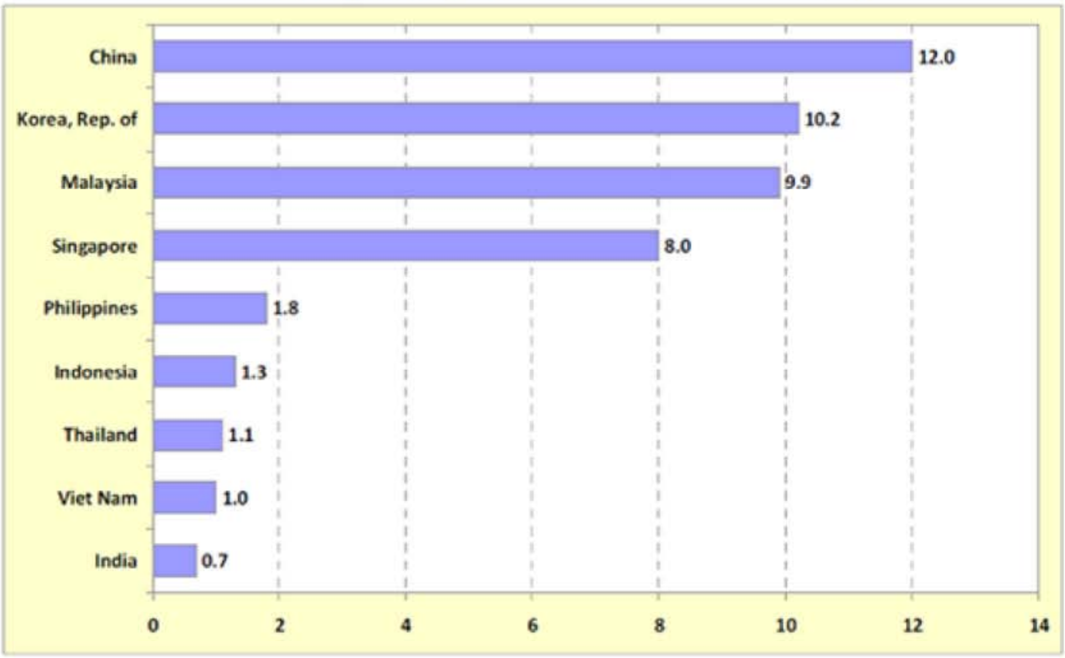


These figures clearly show that most Asian capitalisms suffered from profound imbalances even before the present crisis. Whether they invest clearly too much, as in the case of China, or not enough to sustain high growth in the case of Asian crisis-affected economies, these countries have one thing in common. Real wages increases have lagged behind labour productivity so that the labour income share has fallen and with it domestic consumption. This is what we call a “labour repression-led growth regime”. In these conditions, there can be no rebalancing of Asian economies without a strong recovery of the labour income share combined with a reduction of inequalities and eradication of absolute poverty.

But the political obstacles to be overcome are formidable. Most Asian countries have been ruled by harsh dictatorships, and some still are, that have used extensively state violence to repress the labour movement and secure a high rate of exploitation. Asian economies for instance have won since a long time the infamous title of world champion of “excessive working hours” (Lee, S., McCann D., and Messenger J.C. 2007). Even in the so-called democratic countries of the region, trade unions and political parties from the left have been weakened to the point that there is no organised resistance at the national level, except in South Korea and India, able to counterbalance the power of the business and government elites.

From this, we can understand why most Asian governments have chosen fiscal rescue plans labelled “Keynesian” because they give the priority to huge investment in infrastructure and subsidised loans to private companies. These plans are in some cases huge (see figure 19) but they all try to get around the problem of the necessary wages increases and the reduction of social inequalities. The Chinese plan is the best example.

Figure 19: Fiscal stimulus packages as a share of 2009 GDP (%)



Notes: India, Malaysia and Republic of Korea: combined percentage of two stimulus packages.

Sources: World Bank: *East Asia and Pacific Update: Battling the forces of global recession* (April 2009); authors' estimates.

It will amount to 12% of GDP on a two-year span which is very important on a quantitative point of view. There are numerous uncertainties about the exact number that will be spent because part of it represents spending already planed and another point is that a big part has to be spent by local authorities whose goodwill and capacities is debatable. But the main problem is the structure of the plan itself. Not only there s nothing expected in terms of wage increases but spending in social areas are very small despite all the announcements made by the government about the creation of a universal social security, improvements of the education system and help to farmers.(see table 6).

Table 6: Plan de relance et réforme médicale

- Plan de relance de RMB 4trn étendu sur 2009 et 2010 :

Catégories de dépenses	RMB bn	%
Logement social	280	7
Secteur rural (infrastructures et aide au revenu)	370	9
Transport	1 800	45
Services médicaux, culture et éducation	40	1
Protection écologique	350	9
Innovation	160	4
Reconstruction des régions sinistres du Sichuan	1 000	25
Total	4 000	100

- Réforme médicale de RMB 850bn sur 3 ans pour :
  - Soins médicaux couvrant 90 % de la population
  - amélioration de l'accès et de la qualité des soins médicaux dans le secteur public
  - Aide sociale aux résidents urbains et ruraux

Social housing will represent 7% of total spending; support to farmers (infrastructure and income) 9%; medical services, culture and education 1%, environment 9%, but transport 45%.

The first eight months of 2009 confirm that nothing has really changed. Speculations on stock exchange and investment in real estate have absorbed 45% of the new bank loans decided by the government. Investment has jumped by 33% in manufacturing, transport infrastructures and real estate. Investment in social areas has progressed by a tiny 1.1% (see table 7).

Table 7: contribution to the urban investment growth during the first eight months of 2009

Secteurs	Contribution
Industries manufacturières	8,9 %
Infrastructures de transport	5,6 %
Immobilier	4,9 %
Environnement	4,1 %
Electricité, gaz et eau	2,0 %
Education	0,7 %
Santé, sécurité sociale	0,4 %
Autres	6,4 %
Croissance totale par rapport aux 8 premiers mois 2008	**33,0 %**

Source : CEIC / SER de Pékin

According to Au Loong Yu, there are at least two political reasons explaining why the Chinese government has decided to favour investment in industry and infrastructure once again(Yu, Au Loong 2009). The first is that the state bureaucracy in a broad sense, which has completed its metamorphosis in a capitalist class, now owns directly or indirectly the majority of industrial companies. Giving the priority to wage hikes and social spending would reduce the profit from which they get the major part of their income. As any capitalist in the world they are by instinct fiercely opposed to it. The second reason is that big investment projects in manufacturing, infrastructure and real estate are the main conduit of corruption at all level of the state."It reminds us of one thing again: it is the self-interest of the bureaucracy that defines the package, or any reform" (Yu, Au Loong 2009).

Much the same could be said about the other fiscal packages in other Asian countries, although their social and political system is different. In Japan, the leaders of the LDP which just lost the last general elections were renowned for their fiscal packages in the nineties dedicated to the construction of highways and bridges going nowhere but in poorly populated areas. These spending benefited the local caciques of the LDP who could buy votes and allegiances. It was good for corruption too. The new government of the DJP has announced a change. Money would go in priority to SME and social spending. It remains to be seen if these promises will be fulfilled.

On this basis we can make the hypothesis that the "Asian rebound" will be short-lived because it is not sustainable. For the moment the huge spending launched by the fiscal plan in China will continue to stimulate the Chinese economy in 2009 and 2010.

It will also have, and already has, a bandwagon effect on the rest on the Asian economies. Not only is China the main customer of many Asian countries (Japan, Korea) or one the most important (Thailand, India), but the nature of international trade between China and Asia has changed. It is well known fact that Asian countries exports commodities, parts and components to China which combines them to produce final goods that are the exported to the USA and Europe. But one usually forgets that the other part of these goods is also exported to Asia. There are now consumer products "made in China" everywhere in Asia. In recent years, the region's countries have been trading increasingly with each other rather than with countries outside the region (see Figure 20).

Figure 20 Intraregional trade, selected East and Southeast Asian economies

Sources: Staff estimates based on data from CEIC Data Company Ltd., downloaded 4 August 2009; International Monetary Fund, *Direction of Trade Statistics*, May 2009.

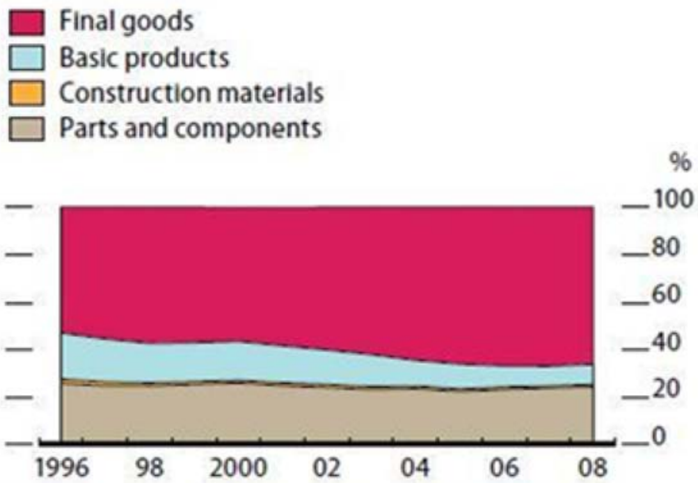
On the whole, the share of intraregional trade has risen from 31.7% in 1990 to 42.0% in 2008. For each individual country, the importance of intraregional trade may vary, but it is increasing for all except China, which reflect the fact that China exports the majority of its final goods to the rest of the world. Nonetheless, a trade of final goods is developing between China and the rest of Asia alongside the trade of parts and components that pertains to production fragmentation. "Crucially, the share of parts and components in Chinese imports from East and South East Asia decreased substantially from 43.6% to 33.8% from 1996 to 2008, and the share of final goods increased appreciably from 43.6% to 54.7% during the same period" (ADB 2009c)(see figures 21 and 22).

These changes can be viewed as a weakening of China's regional role as an assembler and a corresponding strengthening of its role as a consumer. This change gives credit to the idea that Asian regional integration reduces the dependence on exports to western countries and in particular the USA.

It may be true on the long-term but the process is still at the initial stage and although China's rebound has been a significant source of additional net demand in Asia in 2009, it is still not important enough to get the entire region out of the crisis. China is not yet an independent source of demand and growth for East and South East Asia and cannot be until the labour income share and consumption pick up.

This is the reason why, as a conclusion, we make the prognosis that after 2010, all the conditions are met for a new downturn in Asia.

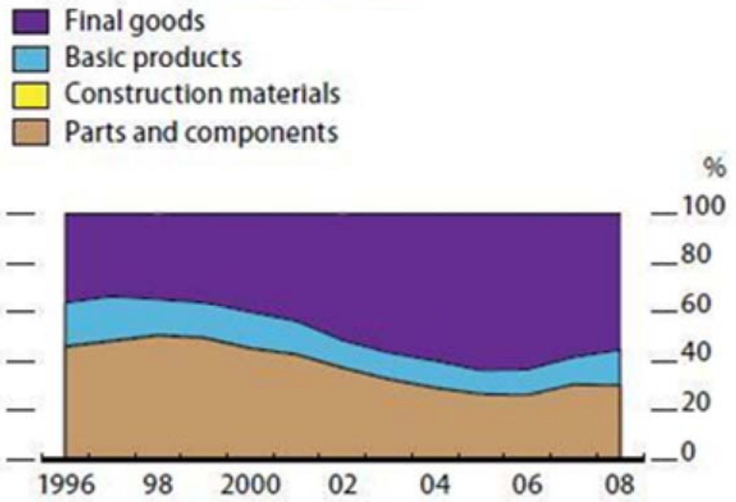
Figure 21: Exports of People's Republic of China to East and Southeast Asia by commodity classification



Note: For composition of East and Southeast Asia, see Box 2.2.1.

Source: Staff estimates based on data from TradeData International Pty. Ltd.

Figure 22: Imports of People's Republic of China from East and Southeast Asia by commodity classification



Note: For composition of East and Southeast Asia, see Box 2.2.1.

Source: Staff estimates based on data from TradeData International Pty. Ltd.

References

ADB. 2009a. "Asia Economic Monitor July 2009." Asia Economic Monitor: 101. Asian Development Bank: Manilla.

ADB. 2009b. "Asian Development Outlook 2009." Asian Development Outlook. Asian Development Bank: Manilla.

ADB. 2009c. "Asian Development Outlook 2009 Upadate." Asian Development OUtlook. Asian Development Bank: Manilla.

BIS. 2009. "The international financial crisis: timeline, impact and policy responses in Asia and the Pacific." The International Financial Crisis and Policy Challenges in Asia and the Pacific". BIS: Shanghai.

Cho, Dongchul. 2009. "The Republic of Korea's Economy in the Swirl of Global Crisis." ADBI Working Paper Series: 25. Asian Development Bank Institute: Tokyo.

Felipe, Jesus and Lim Joseph. 2005. "Export or Domestic-led Growth in Asia?" ERD Working Paper: 51. Asian Development Bank: Manilla.

ILO. 2008a. "Global Wage Report 2008 / 09. Minimum wages and collective bargaining:Towards policy coherence." Global Wage Report: 120. International Labour Organisation: Geneva.

ILO. 2008b. "World of Work Report: Income Inequalities in the Age of Financial Globalization." 178. International Labour Organisation: Geneva.

ILO. 2009. "Global employment Trends Update." Global Employment Report International Labour Organisation: Geneva.

Kim, Kee Beom, Huynh Phu, Sziraczki Gyorgy, and Kapsos Steven. 2009. "The Global Economic CrisisLabour Market Impacts and policies for recovery in Asia." ILO Asia-Pacific Working Paper Series: 39. ILO Regional Office for Asia and the Pacific: Bangkok.

Lee, S., McCann D., and Messenger J.C. eds. 2007. Working Time Around the World: Trends in Working Hours, Laws, and Policies in a Global Comparative Perspective. . London and Geneva, : Routledge and ILO.

Yu, Au Loong. 2009. "China: End of a Model, or Birht of a New One?" New Politics., XII-3:47.