The Impact of the Global Economic Downturn on ASEAN Countries and How to Mitigate the Impact on Poor People

Synthesis Paper

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Synthesis Paper

The cause of global financial and economic crisis in 2008

The global financial crisis started to erupt in July 2007 and reached its peak following the collapse of Lehman Brother in September 2008. Originated in the US financial system, the crisis spread to that of Europe and beyond. Direst loss from the Subprime loans was up to US$9 trillion (see Paitoonpong and Akkarakul 2009). This financial crisis spilled over to the economic sphere of those countries, and then plunged the whole world into full-fledge financial and economic crisis.

Although there has been less consensus on the main cause of the global financial crisis, everyone agrees that the crisis was caused by the combination of the current account imbalances between the United States and export-heavy Asian countries especially China, excessive financial leverage (too complicated financial product innovations) in the US, too loose monetary policy (too low interest rate for too long), loose financial and banking regulations, and therefore housing bubble burst.

The crisis in 2008 was different from the Asian financial crisis in 1997. When the financial crisis hit the East Asia economies, developed economies such as the US and EU, which were Asia's main export destinations, were performing well. The cause of the Asian financial crisis was the weakness in the Asian economies themselves. The strength of those export markets helped bring East Asian economies out of the crisis in a short period of time. Therefore, the recovery after the Asian financial crisis was V-shaped, that is, the economies fell sharply but recovered very fast.

In 2008, the condition of the crisis was viewed as U-shaped. The world economic downturn took a fast dive, but recovered very slowly. It was anticipated that the world economies would experience another extended period of slow recovery before economic growth returns to the pre-crisis level. So the depreciation of Asian currencies in the wake of the global financial crisis cannot help boost exports and economies as have been experienced in the past decade.

The impacts of the global financial and economic crisis on ASEAN economies

Due to the nature of interdependency of the world economies in the era of globalisation, no part of the world has been spared from this global financial and economic crisis. As a result, the world GDP in 2009 decreased 1.3% (see Tran 2009). More than 7.2 millions lost jobs in Asia; and the global inverse capital inflow was 2% of GDP (Ros 2009). Asia is no exception. The ‘‘great’’ economic recession in export destinations such as the US, EU, and Japan affected the ASEAN economies through decrease in demand for their export products, reverse capital inflow, relatively weak currencies against US dollar and other major currencies (when foreign capital was moved to safer places such as the US), decline in remittances by 0.5% (share of remittances in ASEAN is 5% of GDP (see Chongvilaivan 2009) and to a lesser extent its exposure to financial and banking system in the US and EU. As a result, economic growth in ASEAN-5 declined to zero percent in 2009 as compared to 4.9% growth rate in 2008 (IMF).

In empirical analysis of the impact on economic integration for ASEAN-5,using the panel data set to test gravity model of economic integration, Hakim (2009) finds that global economic crisis has negative effects on economic integration of ASEAN-5.

Chongvilaivan (2009) studies the impacts of the global economic crisis and growth prospects in Asia-Pacific by decomposing each economy by three sectors (agriculture, manufacture, and service). He finds that the agriculture sector was hit less severely because it was less exposed to the external market demand compared to the other two sectors (industry and services). While the manufacturing and service sectors tend to be susceptible to the FDI inflow reversals and squeezing labour markets in the crisis epicentre, the agricultural sector stood in a better position to weather the global economic crisis.

The paper added that the resilience of the agricultural sector is perhaps attributable to the stronger dependence on domestic markets and less exposure to international capital markets. The findings would be more robust, had the agriculture sector been subdivided into non-food and food subsectors to check whether food subsector has been less affected by the global crisis than non-food subsectors since the non-food subsectors tend to depend more on export markets than the non-food sub-sectors.

Paitoopong (2009) on the impacts of financial crisis on women in Thailand finds that the global financial crisis affects Thai women than Thai men because the sectors that employed more women in Thailand were affected the most by the crisis such as hotels, restaurants, and manufacturing sectors. These negative effects in turn fell on the elderly because more than 60% of the elderly depended on their married daughters.

Reyes (2009) evaluates how effectively those crisis victims were targeted by government programmes by using panel data to give recommendations on how to improve programme designs and targeting efficiency. She encourages the government to collect data through the community based monitoring system (CBMS) because the existing data at the national or provincial level is too aggregate; survey data on poverty are conducted too infrequently and if available the data cannot be used as a basis for timely response; data on coping strategies is absent; and data on access to government programmes is lacking. In her study on access of NFA programme in the Philippines, Reyes (2009) found that 48.9 % of all households who accessed the programme were considered non-poor, and 35.6 % of poor households were not able to access the programme.

Mohammad et al (2009) investigated whether ‘‘trade openness’’ in Malaysia is positively correlated with output growth at the national, sectoral, and subsectoral levels. The paper finds that trade openness has positive correlation with output growth in Malaysia, but the correlation is not uniform across sectors and levels. The manufacturing sector has positive relationship with output growth while agricultural and service sectors show no significant correlation. At the subsectoral level – electric, electronic, textile, and apparel have strong positive correlation with trade openness while wood product shows no relationship with trade openness. Shipping agency is the only subsector in the service sector that has positive correlation with output growth.

Tambuna (2009) finds that there are excessive micro-enterprises in Indonesia, the number of which is believed to be more than 50 millions. It is viewed as indication of the weakness of the Indonesian economy in vertical mobility from micro into small enterprises. The contribution of small enterprises to employment is by far the largest (90%) but its share in GDP is relatively low (35%). Moreover, the share of medium enterprises to employment is low which may be attributed to fast shifting from labor to capital intensive mode in the Indonesian economy so that between 1996 and 2005 job creation has been stagnant. Tambuna (2009) gives recommendations to increase employment by removing stringent licensing from both local and central government, create a single economic institution to coordinate many different tasks of employment of SMEs, improve worker skills and education, and mobilise and institutionalise industry at the local level, and improve the general business climate.

Sirega (2009) states that the decline in export causes over-supply of food commodities in the domestic market, and then the price decrease. With inelasticity of demand and supply of those products, the price decrease lowers revenues of exporters and farmers. Then some laborers will be laid off and in turn poverty rate will be increased. This finally threatens food security through the prevention of community from having adequate income to access foods. The solution to move out of this situation is to improve the local economy to overcome the decline in purchasing power and maintain food security. On the other hand, the trend of food prices will be predicted to be increasing. When the economic downturn hit ASEAN, the high food prices halted for a time at the end 2008. However, food staple prices started to rise again in the mid of 2009. The demand for food staples seems to exceed supply over the medium and long term (Arifin 2009).

Arifin (2009) also shows food insecurity coincides with poverty incidence and regional disparity of infrastructure by using an Indonesian dataset from World Food Programme. As in other Asian nations, budget for agriculture and rural development in Indonesia had declined around 50% between 1995 and 2005. The paper provides policy recommendation as follow: 1) enhance capacity building in research and development, integration of rural development and employment creation; 2) subsidise and empower the needy and active poor, and combat children malnutrition by promoting food diversification based on local endowments and food technology development; 3) remove local regulations which hinder food distribution.

These two papers on the impacts of the global financial crisis on food security in Indonesia seem at first to suggest different trends of price of food. However, the difference between these two papers is mainly from the different perspectives they took. Arifin (2009) links the impacts of the global financial crisis to the ‘‘financialisation’’ of agricultural communities. The price index of agricultural commodities and other major commodities from November 2007 to November 2009 are highly correlated.

For the impact of the economic downturn on households and communities in Cambodia, Ngo (2009) conducted a survey with 1,070 households from 15 villages of different main economic activities. The study finds that 89% of the surveyed households reported facing many difficulties in their livelihoods. 33% households are affected by job loss while 3.7% households had at least one member lose their job. 61% households reported their fear of food insecurity. Profits in 2009 for main agricultural products such as wet season rice, cassava, and maize declined between 30% and 50% compared to 2008, except dry season rice production whose profit increased about 38%. As in Indonesia, the agricultural sector in Cambodia is the employer of the last resort. However, agriculture gain is unlikely to offset the decline of garment exports and tourism receipts in Cambodia (Lim 2009).

As existing stimulus programmes are fragmented, Lim (2009) recommends the establishment of a clearly mandated focal point or central agency is badly needed. It is important to distinguish the world financial crisis and economic crisis in 2008.

The policy responses of each ASEAN economy

The policy responses to the global crisis of each country shares many similarities based on Keynesian economic paradigm. Each country has introduced a fiscal and monetary stimulus package. In general, the impacts of the fiscal stimulus packages are limited due to small size of fiscal spending, slow implementation, weak multiplier effects, and time lag for the stimulus to take effects. However, the size of the stimulus packages in the Asian economies is far larger than the monetary response. Stimulus package in Malaysia is US$18.1 billion (10% of GDP); Singapore US$13.7 billion (8% of GDP); the Philippines US$6.5 billion (4.6% of GDP); Thailand US$3.3 billion (1.2% of GDP); Vietnam US$7 billion (1.1% of GDP); and Indonesia US$6.1 billion (1.2% of GDP) (see Mohammad 2009). The small size of monetary responses may be attributed to less exposure to Sub-prime loans and conservative monetary authorities in Asia due to risk-averse monetary authorities adopted after the 1997 Asian financial crisis. The share of tax cut in fiscal stimulus package is low, except 20% for Singapore and nearly 80% for Indonesia (see Sirega 2009).

Cambodia

The National Bank of Cambodia lowered the minimum reserve requirement of private banks from 16% to 12%. The budget in 2009 was increased to US$1.8 billion (28% more than that in 2008) (Lim 2009). This is considered by government as quasi-stimulus package though it was not explicitly stated. Cambodia spent US$7.6 million for training laid-off workers in response to the job loss in the garment sector reportedly numbering around 60,000; and construction workers 100,000. Ngo (2009) found that tourism dependent villages were the most hit among the surveyed 15 villages in various parts of Cambodia.

Zero tax was imposed on imports of raw materials and agricultural equipment. The government also reserved US$18 million for agricultural support fund (Ros 2009). 48% of households in July 2008 and 30% of households in July 2009 reported having received some kind of assistance from government or NGOs. Government aid covered 37% of the 1,070 households surveyed; while NGOs contributed mitigating assistance of some sort to 93% of the households surveyed (Ngo 2009). Of aid recipients, 36% of the households received assistance in the form of free health care; 26% received school feeding; 14% received micro-credit; and 10% food for work.

Thailand

In Paitoopong (2009), due to the recent political uncertainty, Thailand has changed governments three times in 2008. The policy responses by each government to the global financial crisis have been changed accordingly, hence not consistent. The first stage of stimulus package under Samak government was worth THB 1.2 trillion to mitigate the financial crisis effects in the short run. Six measures for six months were introduced. The package consists of reduction of excise tax on gasoline; control of cooking gas; free use of pipe water supply and electricity; free use of bus and third class train. The second stage of the stimulus package under Somchai government was introduced mainly to target workers. It aimed to help workers before being laid off and assist laid-off workers to receive compensation and severance pay, provide financial assistance, and train laid-off workers for self-employment. The third stage of stimulus package under Abhisit worth THB 1.835 trillion with additional economic packages of THB 100 billion. The main target was farmers and the poor. The paper considers assistances from the government as available, but usually missing the target. The government did not consult with workers and had no gender consideration. Those who were targeted were less likely to use free service provided by government programmes. The paper attributes the failure to target crisis victims to poor, inefficient, unreliable, and unavailable database and recommends the list of crisis victims should be broken down by gender, age, and location.

The Philippines

Aldana (2009) examines the impact of the crisis on the Philippine macro-economy and the labour market and overviews the policy responses to the crisis. Households who experienced "involuntary hunger” (at least once in three months) numbered 3.7 million in the second quarter though declined to 3.2 millions in the third quarter in 2009. Meanwhile, the poverty rate may increase by 1-1.5% (World Bank 2009). The Economic Resiliency Plan accounting for 4% of GDP was introduced: P160 billion to fund small scale infrastructure; P100 billion large infrastructure; P40 billion tax relief; and P30 billion additional benefits to members.

The impact of the economic slowdown apparently was more on underemployment rather than unemployment; it affected 35% of households. Underemployment rate increased to 18.2% in January 2009. Since remittances account for 12% of GDP, the slow economic recovery will impact on the Philippine households that depended heavily on remittances from abroad. An Emergency Employment programme was initiated for vulnerable sectors, hiring displaced workers or their dependents, and frontloading of infrastructure budget. Aldana (2009) recommends comprehensive social protection system for the poorest of the poor.

With regard to monetary policy, policy rate was lowered by 200 basis points; bank reserve requirement by 2 percentage points. Timely policy issuances to assure market participants of the adequate liquidity and to limit exposure of banks to the financial crisis were also adopted.

Singapore

The Singaporean economy is the hardest hit in Asia because of its high dependency on exports. GDP growth of the Singapore economy declined by 10% in the first quarter of 2009 as compared to 1.1% growth in 2008, and 7.8% growth in 2007. According to Chew (2009), in the past three recessions in 1985, 1997 and 2003, the Singaporean government used industry relation mechanisms by persuading workers to accept wage freeze and reduction in employers’ contributions to the Central Provident Fund. This mechanism was effective because it could increase export to the US, EU, and Japan.

Because of the fragile main export markets for Singapore, this mechanism may not work as in the previous crises. With the surplus of currency Singapore had enjoyed many years, it has much fiscal leeway to spend on stimulus package with domestic financing. Singapore has introduced many measures to subsidise companies to retain jobs, train workers, and hire new graduates. It also encourages workers to stay in labor force in order to get subsidy. Another measure is to encourage the unemployed to look for work in order to enjoy the Work Income Supplement. As a result, GDP fell by 10%

but unemployment rose from 2.5% in the fourth quarter of 2008 to 3.2% in the first quarter of 2009.

The government also spent US$4.4 billion on developing first class infrastructure for the island and on expanded provisions for education and healthcare. In addition, Singapore will implement tax measures and grants for businesses, which will cost US$2.6 billion. It is estimated that 18,000 public sector jobs will be made available over the next two years.

On monetary stimulus package, to encourage bank lending, the government extends US$5.8 billion for a Special Risk-Sharing Initiative but the bank still makes the fundamental decision whether or not to lend. It is expected that Singapore's economic recovery depends on the recovery of the world economy.

Malaysia

According to Mohammad et al (2009), Malaysia has undergone persistent deficits since 1998. As other Asian countries, Malaysian banks have negligible exposure to securities linked to US subprime loans in 2008 because of its financial and banking system is in the better conditions compared to 1997. However, Malaysia suffered from capital flight, hence reverse capital inflow. Malaysia has spent US$18.1 billion, the largest ratio of fiscal stimulus package to GDP (10%), to boost its economy after the decline in exports of electronic and electric products.

The stimulus package was enabled by domestic financing given the ample liquidity in the domestic market. Such aggressive stimulus programmes moderated the negative effects. Though economic difficulties are relatively less painful, Malaysia's economic growth in 2009 is estimated to be low with large fiscal deficits. Debt now has reached 54.2% of GDP (see Thillaisundaram 2009).

Indonesia

In banking sector analysis, Gunadi and Harun (2009) show the resilience of Indonesia's banking sector and lessons learned. The reasons for the resilience are sufficient liquidity, no excessive financial leverage, no credit risk transfer improvement, traditional banking system that follows a "deposit to lend business" model, concentrating funding to small and medium enterprise, low risk exposure to assets which sharply declined in values. Moreover, prudent regulations prevented banks from having exposure in the equity market and real estate market, and other speculative transactions.

The case of banking system in Indonesia can be said to be typical of ASEAN banking system after the Asian financial crisis. Following the bitter experience in 1997, Asia's monetary authorities took a conservative step on financial and banking regulations. The Asian financial sector became much more risk-averse after 1997. So most banks in Asia avoided exposure to the sub-prime loan crisis in 2007. In other words, the Asian nations have increased their foreign reserve, and tightened more stringent regulations, which mitigated the negative effects of the global financial crisis.

After the wake of the global financial crisis, Indonesia suffered from low economic growth mainly caused by a negative growth of export. Indonesia spent US$6.1 billion, which accounts for 1.2% of GDP for stimulus interventions (see Mohammad 2009). In 2009, domestic investment and fiscal stimulus are the main sources of growth besides domestic consumption. Moreover, Indonesia has signed bilateral and multilateral currency swap agreements with many other countries to prevent another crisis, maintain the balance of payments, and boost confidence in government.

Vietnam

In Vo and Le (2009), the impacts of the global financial crisis has reduced the growth rate of GDP, import and export, and FDI inflow. GDP growth in 2008 was 6.2% in the fourth quarter, but it declined to 3.1% in the first quarter of 2009. Imports declined 45% in the first quarter of 2009 against the 28.3% increase in the fourth quarter of 2008. Exports in the fourth quarter in 2008 increased 29.5% but declined to 2.4% in the first quarter in 2009.

After the eruption of the global financial crisis, Vietnam has shifted from inflation control to prevention of economic downturn. The economic stimulus packages worth US$8 billion, 8.7% of GDP, were executed to cope with the negative impacts of the economic downturn. The monetary policy has been more eased to support production and trade activities. As part of the monetary stimulus package, the government supported banks' costs and enterprises' credit access. A number of social protection policies were initiated in response to the weak social protection system.

Policy Recommendations (summarised from all the papers)

- Maintain the market economy system and deepen the regional integration but financial and banking system should be regulated to reduce the risk of financial crisis.

- Deepen the regional integration on monetary and financial system, coordinate foreign exchange policy within and outside the ASEAN, and cooperate on currency swap within and outside the region.

- Improve social safety nets to increase domestic consumption, which is less vulnerable to fluctuations in the world market demand.

- Diversify export destinations by exporting to more countries

- Diversify economic activities as more export-dependent sectors are affected more than less export-dependent sectors

- Increase spending on research and development in agriculture, and increase regional and national food stock reserves.

- Remove regulations that hinder food distribution to increase production and productivity

- Collect regular panel data to provide inputs to policymakers in prioritizing mitigating measures, and determine who benefits from government stimulus programme, and improve targeting efficiency to reach the most needy

- Integrate and coordinate stimulus packages to increase its multiply effects on mitigating the impacts of the global financial and economic crisis

- Subsidise private companies to retain workers and encourage workers to work to receive the subsidy

Initiated by a group of highly committed intellectuals and young professionals, the Cambodian Economic Association (CEA) has now come into existence with a view to the equitable and sustainable development of Cambodia.

CEA aims at promoting debates on social and economic affairs and to participate in the development of the country.

Cambodian Economic Association

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