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Building resilience to crises through regional economic cooperation and integration

Emerging from recent crises: understanding the macroeconomic context

Note by the secretariat

Summary

The present document provides information on the latest macroeconomic developments and challenges in Asia and the Pacific as well as the policy priorities necessary for a robust and resilient economic recovery. The deep and lasting scars of the coronavirus disease (COVID-19) pandemic on the region and the nascent and uneven recovery to date are reviewed. It also contains analyses of two unfolding macroeconomic challenges and associated uncertainties: rising inflation and global monetary policy tightening on the one hand and the implications of the ongoing crisis in Ukraine on the other. The document contains a review of the fiscal challenges that countries in Asia and the Pacific face and of the policy insights necessary to support their robust and resilient recovery through inclusive development, efforts to build forward better and enhanced efficiency in public spending.

Member States may wish to consider policy actions to harness regional cooperation for a robust and resilient economic recovery in a few key areas:

(a) Continuing and expanding regional health cooperation to leave no country behind in COVID-19 vaccination and boost economic resilience against future pandemic shocks;

(b) Strengthening cooperation to facilitate the recovery in international tourism;

(c) Maintaining an integrated regional market, facilitating high-quality cross-border investment and expanding the sectoral coverage in services trade and investment to further enhance the region’s resilience;

(d) Promoting multi-stakeholder debt discussions to bring all stakeholders together for innovative and effective debt relief solutions and to avoid a dangerous spiral that risks harming all;

(e) Strengthening regional tax cooperation through coordinated regional voices, closer-to-the-ground capacity support and a more inclusive regional platform for countries currently left behind in global initiatives;

(f) Advancing regional and global cooperation on economic and fiscal policies for climate action and a transformation towards green economies.

Member States may wish to deliberate on the above-mentioned topics and provide guidance to the region.

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** ESCAP/MCREI/2022/L.1.
I. Introduction

1. The present document is intended to inform the discussion on building resilience to crises through regional cooperation and economic integration. It contains a review of the latest macroeconomic developments in Asia and the Pacific, the main emerging macroeconomic challenges and potential policy priorities for robust and resilient economic recovery.

II. Nascent and uneven recovery from the pandemic

2. The coronavirus disease (COVID-19) pandemic halted the region’s momentum in terms of economic growth and took a heavy toll on people’s livelihoods. Regional economic output plunged, and three in four countries suffered an economic recession. In 2020 alone, the number of working hours lost was equivalent to the loss of 140 million full-time jobs.\(^1\) Years of progress towards Sustainable Development Goal 1 (No poverty) were wiped out, with an estimated 85 million people pushed back into extreme poverty by the end of 2021.\(^2\) The region’s overall progress towards achievement of the Sustainable Development Goals may slow down further in the coming years as a result of continuing economic difficulties, as highlighted by the Economic and Social Commission for Asia and the Pacific (ESCAP) in its publication Asia and the Pacific SDG Progress Report 2022: Widening Disparities Amid COVID-19.\(^3\)

3. Encouragingly, the region’s economic rebound from the pandemic has been swift and strong. Economic growth in East and North-East Asia quickly turned positive by the third quarter of 2020, followed by South and South-West Asia in the fourth quarter of 2020, and South-East Asia and North and Central Asia in the second quarter of 2021. Although Pacific small island developing States continued to face economic difficulties, developing economies in Asia and the Pacific, as a whole, expanded by 7.1 per cent in 2021.

4. Recovery in merchandise trade and the resilience of regional value chains played a central role in this economic rebound, driven by increases in external demand for electronics, semiconductors, machineries and other consumer durables (see figure I). The gradual transition to living with COVID-19 was another important factor. Most countries have reduced restrictive measures, given the lower lethality of the Omicron variant, progresses in COVID-19 vaccination, and improved monitoring and treatment of the disease. Although the pandemic remains a main risk factor for the near-term economic outlook, it is clear that the economic crisis triggered by COVID-19 has entered the recovery phase.

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\(^3\) United Nations publication, 2022.
Figure I
Merchandise exports led the regional economic recovery


5. However, policymakers should not be overly optimistic about this recovery. Much of the higher-than-usual economic growth in 2021 was boosted by the low starting base of the previous year. Developing Asia-Pacific economies are projected to grow at a more moderate pace of 4.5 per cent in 2022 and 5.0 per cent in 2023. More importantly, the economic recovery has been and is likely to remain uneven. For example, countries suffering from pre-existing economic vulnerabilities and countries more exposed to tourism and remittance shocks were much slower to recover. For many, economic output had yet to recover to 2019 levels at the end of 2021 (figure II).
6. Economic recovery in North and Central Asia has been interrupted by the ongoing crisis in Ukraine and economic sanctions against the Russian Federation. The subregion is projected to experience a double-dip recession in 2022. The economic outlook for Pacific island developing States is also not great. The subregion already weathered two consecutive economic recessions, in 2020 and 2021. Although economic growth is expected to rebound to positive figures this year, the 2022 economic output may still fall short of the 2019 level. In particular, the slow recovery in global services trade and international tourism continues to negatively affect the subregion’s tourism-dependent economies, such as those of the Cook Islands, Fiji, Palau, Samoa, Tonga and Vanuatu.

7. The regional economic outlook is riddled with other uncertainties as well. The COVID-19 pandemic, especially the new variants and renewed outbreaks, remains a significant macroeconomic threat. The economic deceleration in China may have a spillover effect on its closest trade partners. Compounded by a potential decline in demand for products from outside the region, this may lead export growth to plateau in Asia and the Pacific. Concerns about macroeconomic stability are increasing as well. Shrinking fiscal space, particularly in South and South-West Asian economies, amid tightening financial conditions, may slow down the nascent recovery and push vulnerable economies to the brink of collapse. The worst-case scenario of stagflation is now becoming a reality as well; with inflation rising globally, a deceleration in the pace of recovery of the real economy seems imminent, partly as a result of the long-term scarring effects of COVID-19 (box).
**Scarring effects of the coronavirus (COVID-19) pandemic**

**Disruptions to labour markets.** Protracted labour market disturbances negatively affect the quality of the workforce and future productive potential. Prolonged duration of unemployment, in particular, erodes workers’ skills and reduces their chances of returning to the workforce.

**Lack of capital investment.** Weakened economic prospects and balance sheets may lead to an extended period of low investment, which in turn reduces productivity. Private investment in capital or research and development may also be subdued by uncertain economic prospects and less availability of credit, eroding future growth potential.

**Learning deficits.** A unique effect of the COVID-19 pandemic is the learning and earning loss from prolonged school closures, which were as long as 63 weeks in Asia and the Pacific.* This was further exacerbated by the digital divide, with long-term consequences on learning and earning potential.**

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### III. Emerging macroeconomic challenges due to rising inflation and the crisis in Ukraine

8. Between the end of 2021 and early 2022, two major global economic uncertainties emerged. First, inflationary pressures linked to persistent supply disruptions as well as unprecedented monetary easing and fiscal stimulus have begun to materialize. This has led to a high likelihood of rising interest rates worldwide, especially in major developed economies, which is likely to send ripples across the global financial markets. Second, the ongoing crisis in Ukraine and related economic sanctions have resulted in significant economic disruptions, global price surges and supply shortages in fuel and food. This crisis threatens to not only plunge the Asia-Pacific region back into economic turmoil but to also aggravate global inflation and jeopardize socioeconomic stability in many Asia-Pacific developing countries.

**A. Global monetary tightening and financial flow uncertainties**

9. Rising inflationary pressures in the United States of America, the euro area and Latin America have triggered a general reversal in monetary policy stances. The United States Federal Reserve already raised the policy rate by 75 basis points in March and May 2022 to cope with the worst inflation in 40 years, while the European Central Bank also scaled back its asset purchase programmes and signalled interest rate hikes within the year.

10. Such a dramatic policy shift is expected to increase the risks of capital outflows from developing Asia-Pacific countries, and policymakers may feel compelled to raise interest rates to avoid a vicious circle of capital flight, currency depreciations, growing domestic inflation pressures and macroeconomic instability. The pressure also comes from within the region, with the headline inflation rising an average of 7.3 per cent in March 2022 and surpassing central bank targets in a number of countries (figure III). In response, most North and Central Asian economies, as well as India, Pakistan, the Republic of Korea, Singapore and Sri Lanka, have already increased policy rates.
Figure III
Rising inflation in Asia and the Pacific
(Percentage)


B. The crisis in Ukraine and its economic implications

11. Rising interest rates imply higher borrowing costs. For governments, fiscal space will be further squeezed, debt servicing will be more costly and debt refinancing may be more challenging. The private sector and households are also likely to encounter more liquidity constraints going forward. Given the context of a general deceleration in global economic growth and greater spending needs to sustain the nascent and fragile economic recovery, balancing between macroeconomic prudence and policy continuity will be a significant and delicate policy challenge for Asia-Pacific countries in the coming years.

12. The crisis in Ukraine is expected to exert an additional drag on the economies of the region and increase macroeconomic uncertainties through a number of channels (figure IV). Most importantly, the crisis may result in a prolonged period of high prices of essential commodities. Taken together, the Russian Federation and Ukraine are the world’s major exporters of commodities such as oil, gas, nickel, wheat, sunflower oil and fertilizer. The price of crude oil, coal and natural gas has already experienced surges since the outbreak of the crisis in February 2022, while the Food Price Index of the Food and Agriculture Organization of the United Nations also reached an all-time high in March 2022 before softening marginally in April. Given that most Asia-Pacific countries are net energy and food importers, and these two items can account for up to 40 per cent of the consumer price index basket in some countries of the region, the potential impact of the crisis on economic growth and inflation could be sizeable.
Figure IV
How the crisis in Ukraine may affect the macroeconomic performance of Asia-Pacific countries

- Higher global commodity prices
- Weaker global demand
- Higher economic uncertainty


Note: The box colour represents different eventual economic impacts.

13. ESCAP estimates suggest that the overall loss in economic output in Asia and the Pacific could amount to 0.5 per cent (approximately $170 billion) relative to the baseline if global oil prices reach an average of $120 per barrel in 2022 as a result of the crisis in Ukraine. Under the same scenario, inflation could be higher by 3.5 percentage points above the baseline. If such an impact materializes, some 2.7 million additional people are expected to fall back into extreme poverty due to lower consumption and higher inflation.

14. At the country level, the Russian Federation will take the brunt of the economic blow. It is projected to suffer a deep economic recession of 8.6 per cent in 2022 with only a moderate recovery of 2.0 per cent in 2023. For other countries of the Asia-Pacific region, direct risk exposure to the conflict is concentrated in three areas: energy, food and finance.

15. Cambodia, Pakistan, Solomon Islands and Vanuatu are more exposed to rising energy prices than other Asia-Pacific countries due to their large net fuel imports relative to gross domestic product (GDP), high dependence on fossil fuels as key energy sources and weak energy access in general (as

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5 Ibid.
reflected in access to electricity). When considering the size of net fuel imports alone, Nauru, Palau and Nepal rank at the top of the list, although electricity generation in Nepal primarily depends on hydroelectric sources.

16. Georgia, Kiribati and Solomon Islands appear more exposed to surging food prices than other regional peers. These countries rely heavily on imported food items for domestic consumption and are already facing serious concerns regarding food insecurity. Maldives and Samoa also rely heavily on imported food items for domestic consumption, although general food insecurity is less prevalent among their populations.

17. About half of developing Asia-Pacific economies are exposed financially to the crisis in Ukraine due to their weaknesses in fiscal space, dependence on external financial flows (including tourism revenues and remittance) and exposure to external debt, as well as a lack of sophistication and the weak health of their domestic banking sectors and equity markets.

IV. Fiscal space and debt sustainability

18. In response to the socioeconomic crisis induced by the pandemic, Asia-Pacific countries deployed substantial fiscal measures to save lives and livelihoods and reinvigorate their economies. Consequently, the average fiscal deficit for Asia-Pacific developing countries increased from 1.2 per cent of GDP in 2019 to 5.0 per cent in 2020 and to an estimated 6.0 per cent in 2021, with a forecast of 5.6 per cent in 2022. ⁶ Public debt-to-GDP ratios increased considerably across the board during this period as well. The average public debt-to-GDP ratio for developing Asia-Pacific countries reached 50 per cent in 2021, compared to just 30 per cent in 2019.

19. Not surprisingly, debt sustainability concerns have come to the fore in a few countries. For example, public debt-to-GDP ratio exceeds 80 per cent in Fiji, India and Pakistan, and 100 per cent in Sri Lanka, Maldives and Bhutan. The Governments of Sri Lanka and Pakistan are also seeking liquidity support from IMF to restore fiscal stability in the near term. In a scenario of a prolonged economic stagnation, fiscal and debt sustainability concerns are likely to become a serious policy challenge for many more Asia-Pacific developing countries.

20. Additional risks are associated with a growing share of external debt in the structure of public borrowing. Between 2009 and 2019, the public and publicly guaranteed external debt as a percentage of GDP in the Asia-Pacific developing countries increased from 22.1 per cent to 26.2 per cent. ⁷ Within that percentage, foreign currency-denominated sovereign bonds grew more than five-fold in dollar terms, with their share in total external debt increasing from 19 to 50 per cent. Although access to foreign capital and to the bond market is generally desirable, the rise in external debt owed to private bondholders tends to increase the debtor country’s fiscal risk exposure to exchange rate fluctuations and sovereign credit ratings and leads to additional complications in debt relief negotiations.

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⁶ ESCAP calculations based on International Monetary Fund (IMF), Fiscal Monitor Database. Available at https://data.imf.org/?sk=4be0c9cb-272a-4667-8892-34b582b21ba6 (accessed on 15 December 2021).

⁷ Unweighted simple average.
21. In the context of rising interest rate trends globally and associated financial tightening, together with a growing emphasis on fiscal prudence, the challenge of reduced fiscal space is likely to persist, and fiscal consolidation pressures may increase. The mismatch between public spending needs for a sustained recovery and effective pursuit of the Sustainable Development Goals and the fiscal means that Asia-Pacific countries can mobilize in a sustainable manner may further increase. Finding innovative solutions to such fiscal challenges will be a central policy question for Asia-Pacific developing countries in the coming years.

V. Policies for robust and resilient economic recovery

A. Prioritizing inclusive development to avoid a K-shaped recovery

22. High and rising economic inequality was a major development challenge in Asia and the Pacific even before the COVID-19 pandemic and the crisis in Ukraine. ESCAP estimates suggest that the region’s average income inequality, measured by the Gini coefficient, increased by more than 5 percentage points between the early 1990s and early 2010s, with wealth concentration reaching unprecedented levels in some places.  

23. The COVID-19 pandemic has further exacerbated such trends. It has triggered a worldwide deceleration in the economic convergence between developed and developing countries due to the unevenness in access to COVID-19 vaccination, fiscal support packages and post-pandemic adaptations such as teleworking and distance learning.

24. The pandemic has disproportionately affected low-skill low-income workers, who are concentrated in contact-intensive sectors and informal employment. These workers also risk being left behind in the adaptation to new job requirements due to the persistent digital divide and differences in the teleworkability of high-paying and low-paying jobs. This, together with uneven access to distance learning, is likely to result in further labour productivity divergence between the rich and the poor, breeding new inequalities and reducing social mobility in the long run.

25. It is widely recognized that high and persistent inequality stifles economic growth and is a threat to overall social harmony and stability. In contrast, an inclusive recovery can better support the rebound in aggregate demand, given poorer households’ greater marginal propensity to consume. Therefore, it is paramount for Asia-Pacific policymakers to take deliberate and concerted policy measures to ensure that the post-pandemic recovery is inclusive so that it is robust and sustainable.

26. First, in the context of narrowing fiscal space, public spending on health, education and social security should be the last to be reduced, and policy continuity on these fronts should be prioritized. Such social expenditures are typically sacrificed during fiscal consolidations, which tend to increase the income Gini coefficient and reduce per capita income in subsequent years (figure V). Improved targeting of public spending and welfare with a focus on supporting low-income and marginalized groups can significantly enhance their inclusive development payoffs when resources are limited.

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8 *Inequality in Asia and the Pacific in the Era of the 2030 Agenda for Sustainable Development* (United Nations publication, 2018).

9 *Economic and Social Survey of Asia and the Pacific 2022: Building Forward Fairer.*
Figure V
Impact of fiscal consolidations on the Gini coefficient and gross domestic product per capita

Note: Results from impulse-response function. The shaded area presents 95 per cent confidence interval.

Abbreviation: GDP, gross domestic product

27. Second, government support for labour market recovery needs to be sustained and strengthened. Preserving and creating productive jobs for all is probably the single most important element for an inclusive recovery and long-term equality. Approximately 70 per cent of Asia-Pacific economies introduced employment protection and incentives for private hiring in 2020, which contributed significantly to mitigating the socioeconomic shocks of the COVID-19 pandemic. In the post-pandemic recovery phase, public facilitation of job searches and retraining workers will become more important, especially in view of the accelerated digital transformation.

28. Last but not least, economic redistribution through progressive taxation and targeted fiscal transfers should remain an important policy tool for inclusive economic recovery. The use of digital technology and strengthened efforts in statistics collection can enable better targeted, more transparent and more accountable fiscal transfers, taxation and public service delivery in many Asia-Pacific developing countries. Equipped with technology and data, governments will have a better chance to address the undesirable inequality side effect of market mechanisms and carry out poverty alleviation campaigns in a more cost-efficient manner.

B. Building forward better to boost economic resilience, including to non-economic shocks

29. In the past, the question of how to mitigate setbacks, in other words build resilience, did not receive as much policy attention as the question of how to accelerate growth. But the COVID-19 pandemic and, more recently, the crisis in Ukraine are a wake-up call that non-economic shocks can cause large economic losses and create long-term economic scars. Building resilience to shocks should become a top policy priority for robust post-pandemic recovery.
30. The Asia-Pacific region is no stranger to shocks with deep and persistent impacts. In an analysis of 450 major adverse events in the region since the 1960s, ESCAP research finds that following a financial crisis, investment collapsed by nearly 20 per cent in the first year and failed to return to the pre-crisis level even after five years. Similarly, the unemployment rate and income inequality increased notably following pandemics, possibly due to uncertainty and reallocation effects as well as unequal access to health care. Environmental well-being also deteriorates in the face of shocks; natural disasters generate waste and pollution, while economic recessions divert resources away from green investments. Unless they are well managed, adverse shocks could reverse hard-won gains across the three dimensions of sustainable development.

31. Pre-existing vulnerabilities can amplify shocks and make recovery more difficult. In contrast, as shown by past experience, countries that were equipped with stronger social and physical infrastructure and those that managed to respond more swiftly and forcefully suffered less from shocks. For instance, with regard to trade shocks, countries with low health and social protection expenditures and widespread vulnerable employment faced larger setbacks in economic growth, poverty, inequality and human capital. Natural disasters were more devastating for countries with low-quality infrastructure and less diversified economies.

32. Investing in people and the planet is thus critical to enhance the economic resilience of countries in times of crisis. ESCAP research shows that a development path aligned with the Sustainable Development Goals can promote rather than hinder economic growth as a result of increased resilience. A building forward better policy package with the goal of universal access to health care and social protection, closing the digital divide, and strengthening climate and energy actions can potentially reduce the number of poor people in the region by almost 180 million and cut carbon emissions by approximately 30 per cent, while also increasing long-term economic output by 10 to 12 per cent.

33. However, for Asia-Pacific least developed countries, the task of achieving economic resilience could far exceed their capabilities. On the one hand, least developed countries face a significant resilience gap and lag behind in almost all resilience dimensions such as social protection, environmental safeguards, quality infrastructure, economic diversification and productivity. On the other hand, their own public budgets and access to sovereign borrowing are highly limited. External support from development partners and through regional economic and development cooperation would be indispensable to make sure that least developed countries are not left behind in the transition to resilient economies.

C. Spending smartly

34. In light of reduced fiscal space, Asia-Pacific Governments need to consider how to improve the efficiency and effectiveness of public spending to generate the greatest development payoffs. Improved governance and public investment management pay significant dividends. For instance, according to

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11 Ibid.
some estimates,\textsuperscript{12} Asia-Pacific developing countries could achieve similar levels of output or outcome in the health and education sectors while using 30 per cent fewer resources. Potential savings could be even higher for infrastructure investments, through better project appraisal, selection, management and implementation, as well as more effective coordination among government branches.

35. Advance planning during normal times is particularly important to avoid ill-conceived investments or inefficient spending when projects have to be hastily put together in response to emergencies. Maintaining a healthy pipeline of well-developed candidate projects during normal times, in preparation for situations when fiscal expansion is needed quickly, is a best practice worth spreading. In drawing on the lessons learned from the COVID-19 pandemic, it would also be crucial to account for potential risk factors in project development and planning.

VI. Issues for consideration

36. Developing Asia-Pacific countries face a complex and challenging macroeconomic environment in the coming years. The persisting threat and scarring effects of the pandemic continue to exert a drag on economies. Major unfolding macroeconomic uncertainties, global monetary tightening and the crisis in Ukraine cast additional shadows over near-term prospects. Fiscal conditions may further deteriorate, and fiscal sustainability is being tested.

37. As highlighted in section V, a robust and resilient recovery would require policies for inclusive development, building forward better and enhancing spending efficiency. While achieving these objectives will primarily depend on consistent domestic effort, actions by member States to harness regional cooperation will also be indispensable and valuable in a few areas as outlined below.

38. Sustained economic recovery depends on Governments’ preparedness for a safe transition towards living with COVID-19. Poorer and vulnerable developing countries of the region are still left behind in COVID-19 vaccination and medical system resilience. Continued and expanded regional health cooperation will be crucial for both short-term economic concerns and long-term economic resilience.

39. Continued and expanded regional health cooperation will be particularly important for accelerated recovery in international tourism, which provides an essential economic lifeline for many smaller and more vulnerable Asia-Pacific countries and poor population groups. When countries are still cautious about fully opening up borders, travel bubbles and other innovative arrangements between tourism source countries and destination countries are urgently needed.

40. Trade and investment cooperation, especially with regard to regional value chains, provide a unique resilience edge and competitive strength for Asia and the Pacific in difficult times. Maintaining an integrated regional market, facilitating high-quality cross-border investment and expanding the coverage of different services sectors in the integrated regional market through

\textsuperscript{12} Economic and Social Survey of Asia and the Pacific 2019: Ambitions beyond Growth (United Nations publication, 2019).
services trade and investment agreements would be desirable directions to pursue.

41. In view of the growing fiscal pressure, greater momentum is required in regional cooperation on the fiscal front. Multi-stakeholder debt discussions can be essential for bringing all stakeholders (including private stakeholders) to the table, finding innovative relief solutions for countries in debt distress and avoiding a dangerous spiral that risks harming all. These discussions can be especially helpful for Asia and the Pacific, where debtors and creditors are often both from within the region.

42. Regional tax cooperation to combat tax base erosion and international harmful tax practices is also valuable. Coordinated regional voices, closer-to-the-ground capacity support and a more inclusive regional platform for countries currently left behind in global initiatives can potentially benefit all and ensure fair outcomes of the ongoing international tax reforms.

43. Greater regional and global cooperation on economic and fiscal policies for climate action and a transformation towards green economies could be highly constructive as well. For instance, greater regional participation would be valuable in initiatives such as the Coalition of Finance Ministers for Climate Action, which brings together fiscal and economic policymakers from 10 developing and 2 developed countries in Asia and the Pacific, among other countries, to incentivize climate-informed public expenditures and promote the adoption of climate-related fiscal policies and tools such as carbon taxes.

44. Member States may wish to deliberate on the above-mentioned topics and provide guidance to the region.