

ADB

ASIAN DEVELOPMENT

# Outlook 2006

**Routes for Asia's trade**

Asian Development Bank

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# Foreword

The *Asian Development Outlook 2006* is the 18th edition of the annual comprehensive economic report on the developing member countries of the Asian Development Bank.

*ADO 2006* provides an assessment of recent economic performance for 43 developing member countries, and projections for major macroeconomic indicators for 2006 and 2007. This year's *ADO* features a new format for country chapters, including an expanded graphical presentation of information. The outlook also reviews medium term (2006–2010) opportunities and constraints facing developing countries of Asia and the Pacific.

In 2005, developing Asia grew by 7.4%, well above the recent trend, although not quite matching the 7.8% growth rate reached in 2004. Growth was again supported by favorable conditions in the global economy and by robust growth of global trade. In 2005, the People's Republic of China and India grew rapidly, and Pakistan grew at its fastest rate in over two decades. Net oil exporters such as Azerbaijan, Kazakhstan, and Viet Nam benefited from high oil prices. In most other countries, growth was healthy.

So far, developing Asia has been largely resilient to high oil prices, which rose by 42% in 2005. In a majority of countries, consumers were shielded against rising prices through direct or indirect subsidies. Eventually, these costs will have to be met by taxpayers. In countries that determinedly cut subsidies, such as Indonesia and Thailand, growth was crimped, but fiscal resources have been released for projects that can help support growth over the longer term. For the most part, inflationary expectations have been held in check and monetary authorities were adroit in raising interest rates.

The global outlook should again be broadly supportive in 2006 and 2007. The upswing in the electronics cycle, which started in 2005, should continue through 2006, and benefit Asian producers and exporters of electronics goods and parts. Global trade is expected to expand at a robust pace and commodity price inflation should taper off. Oil prices are expected to average over \$60 a barrel, but volatility is also likely because of tight supply conditions. Interest rates will probably nudge up in many countries in 2006, and there is little scope for fiscal maneuver. Fuller pass-through of higher oil prices to end-users is expected to be a priority in many countries in 2006.

In these circumstances, growth in developing Asia in 2006 is expected to ease to 7.2% and to come down further to about 7% in 2007 as cyclical support for growth recedes. But these aggregate projections are likely to mask some diversity. As a result of conscious policy efforts, growth is expected to soften a bit in the People's Republic of China. But stronger domestic demand is seen lifting growth in the Republic of Korea in 2006. In India, growth may come off a little in 2006, before picking up again in 2007. In Southeast Asia, overall growth is expected to change little from 2005, but with a checkered pattern across countries. Indonesia may slow in 2006 as domestic demand is pinched by higher interest rates, but Thailand's growth should recover as the impact of the tsunami and a bad agricultural harvest in 2005 recede. Developing Asia will continue to run a large current account

surplus with the rest of the world in 2006 and 2007, but there is already evidence of some adjustment, with domestic demand picking up and growth of international reserves slowing.

The profile of risks remains much as before, but these risks are probably more accentuated. A disorderly unraveling of global payments imbalances, an antigen shift of the H5N1 virus (avian flu) to people, yet higher oil prices, or a surge in trade protectionism would unsettle the outlook.

Trade will feature prominently in Asia's medium-term outlook and longer-term development prospects. The *ADO 2006* explores Asia's interests in a successful conclusion to the Doha trade talks. A key message is that developing Asia—a region that has prospered due to its openness—has a strong interest in an agreement that paves the way for significant multilateral liberalization. Much of the potential gain to developing Asia from Doha would come through reducing its own levels of protection. Developing Asia's interests would also be best served by World Trade Organization rules that curb contingent protection measures (such as antidumping).

Last year, the *ADO 2005* noted the risk to some countries posed by the elimination of textile and clothing quotas at the end of 2004. Encouragingly, data from the European Union and United States show that large Asian textile and clothing suppliers have expanded their market shares in the first year of the post-quota era. The textile and clothing industry continues to be an important source of export revenue and jobs, particularly for women, in low-income developing Asian economies. If the industry is to remain competitive, though, governments—especially—need to do more. For example, relaxing the restrictions on foreign investment would help improve efficiency.

Finally, bilateral trade agreements that crisscross the globe are proliferating, and Asia is being swept along by this trend. Developing Asia's participation in bilateral agreements is motivated by a wide variety of commercial and strategic interests that stretch beyond the region. However, uncoordinated bilateral agreements risk switching trade from lower- to higher-cost producers (trade diversion) and can raise frictions to commerce, through, for example, complicated rules of origin. A notable concern is the possibility that poorer countries may become marginalized, which could stymie their broader reform efforts. The *ADO 2006*, using a global economic model, sets out what is at stake through possible trade diversion. It also proposes steps that can mitigate risks. Measures such as better port infrastructure or improved customs facilitation offer possible gains to low-income countries by allowing them to get their products to world markets faster, and more cheaply. Initiatives like these, complemented by trade liberalization on a broader front, could confer substantial benefits on developing Asia.



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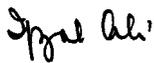
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# Contents

## Part 1 Developing Asia and the world 1

### Developing Asia and the Pacific: Performance and prospects 3

- Performance in 2005 3
- Outlook for 2006 and 2007 9
- Medium-term prospects and challenges 12
- Risks 15

### Prospects for the world economy in 2006 and 2007 18

- Outlook for major economies 18
- World trade and commodity prices 20
- Capital flows and markets 22

### Subregional summaries 24

- Central Asia 24
- East Asia 26
- South Asia 28
- Southeast Asia 31
- The Pacific 33

### Textiles and clothing in the post-quota era: The outlook for Asian suppliers 36

- Introduction: An end to quotas? 36
- Historical perspective on textiles and clothing in Asian development 38
- Recent performance under the ATC and in the (almost) post-quota era 42
- Impact of new US restrictions on the PRC's shipments of textiles and clothing 50
- Agenda for future trade reform 53

### The Doha Development Agenda:

#### Asian challenges and prospects after the Ministerial Meeting in Hong Kong, China 58

- Introduction 58
- Key issues in the Doha Development Agenda 61
- Gauging the gains of Doha trade liberalization for the region 74
- Beyond Doha 76

## Part 2 Economic trends and prospects in developing Asia 83

### Central Asia 84

- Armenia 85
- Azerbaijan 90
- Kazakhstan 95
- Kyrgyz Republic 100
- Tajikistan 104
- Turkmenistan 108
- Uzbekistan 111

### East Asia 116

- People's Republic of China 117
- Hong Kong, China 125
- Republic of Korea 129
- Mongolia 133
- Taipei, China 137

**South Asia 141**

Afghanistan	142
Bangladesh	147
Bhutan	155
India	158
Maldives	168
Nepal	171
Pakistan	177
Sri Lanka	185

**Southeast Asia 191**

Cambodia	192
Indonesia	197
Lao People's Democratic Republic	203
Malaysia	207
Myanmar	212
Philippines	214
Singapore	220
Thailand	224
Viet Nam	229

**The Pacific 236**

Fiji Islands	237
Papua New Guinea	240
Democratic Republic of Timor-Leste	244
Small Pacific countries	248

**Part 3 Routes for Asia's trade 265**

Introduction	267
The drivers of trade and integration in Asia	269
The rise of bilateralism	275
Trade scenarios: Potential benefits and risks	280
An agenda for trade and integration in Asia	289
Conclusions	296

**Statistical appendix 303**

Statistical notes and tables	304
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# Definitions

The economies discussed in the *Asian Development Outlook 2006* are classified by major analytic or geographic groupings. For purposes of *ADO 2006*, the following apply:

- **Association of Southeast Asian Nations (ASEAN)** comprises Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam.
- **Developing Asia** refers to 43 developing member countries (DMCs) of the Asian Development Bank discussed in *ADO 2006*.
- **East Asia** comprises People's Republic of China; Hong Kong, China; Republic of Korea; Mongolia; and Taipei, China.
- **Industrial countries** refer to the high-income OECD members defined in World Bank, available: <http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/0,,contentMDK:20421402~pagePK:64133150~piPK:64133175~theSitePK:239419,00.html>.
- **Southeast Asia** comprises Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam.
- **South Asia** comprises Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka.
- **Central Asia** comprises Armenia, Azerbaijan, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan.
- **The Pacific** comprises Cook Islands, Fiji Islands, Kiribati, Republic of the Marshall Islands, Federated States of Micronesia, Nauru, Papua New Guinea, Samoa, Solomon Islands, Democratic Republic of Timor-Leste, Tonga, Tuvalu, and Vanuatu.
- Unless otherwise specified, the symbol "\$" and the word "dollar" refer to US dollars. Currency abbreviations are given in Statistical Appendix Table A19.

The *Statistical Notes* give a detailed explanation of how data are derived. *ADO 2006* is based on data available up to **15 March 2006**.

# Acronyms and abbreviations

AFTA	ASEAN Free Trade Area
ASEAN	Association of Southeast Asian Nations
ATC	Agreement on Textiles and Clothing
CAR	Central Asian republic
CEPA	Closer Economic Partnership Arrangement
CPI	consumer price index
CY	calendar year
DMC	developing member country
EU	European Union
FDI	foreign direct investment
FY	fiscal year
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GEMAT	General Equilibrium Model of Asian Trade
GNP	gross national product
GSP	Generalized System of Preferences
GST	goods and services tax
IMF	International Monetary Fund
IT	information technology
Lao PDR	Lao People's Democratic Republic
MFA	Multifibre Arrangement
NAMA	Non-Agricultural Market Access
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
PBC	People's Bank of China
PRC	People's Republic of China
PRGF	Poverty Reduction and Growth Facility
R&D	research and development
RBI	Reserve Bank of India
SARS	severe acute respiratory syndrome
SME	small and medium enterprise
SOCB	state-owned commercial bank
SOE	state-owned enterprise
T&C	textiles and clothing
UN	United Nations
US	United States
VAT	value-added tax