

DEVELOPING ECONOMIES OF THE ESCAP REGION

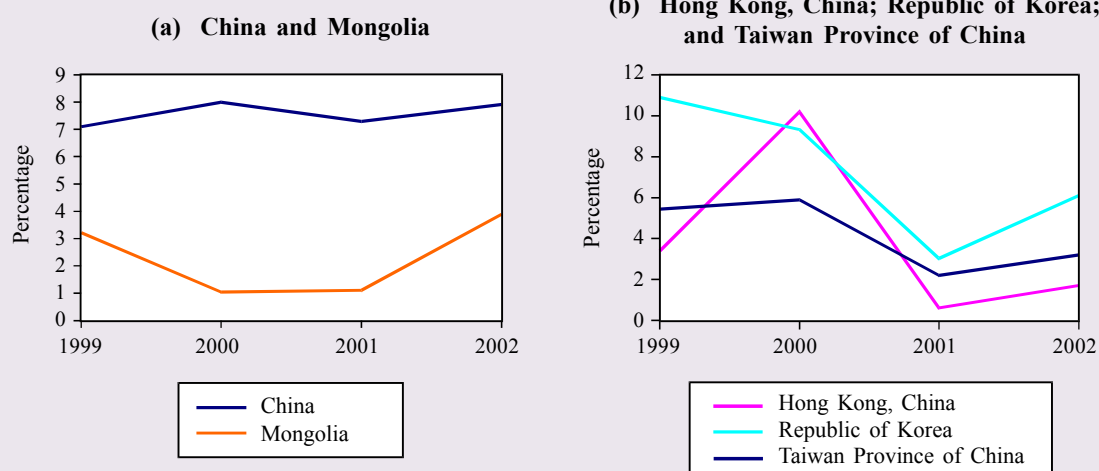
East and North-East Asia

Subregional overview and prospects

The economy of China remained robust and other economies of the subregion staged a strong economic performance

The economic recovery in the subregion, which began late in 2001, continued to strengthen in the first half of 2002, but the momentum slowed mid-year as the global economic outlook became increasingly uncertain. China registered solid annual growth of 7.9 per cent, buttressed by strong domestic demand and improved external demand, while the Republic of Korea achieved a growth rate of 6.1 per cent in 2002, more than double the previous year's performance (figure II.1). Mongolia more than tripled the previous year's growth rate to reach 3.9 per cent in 2002, while the comparatively low growth rate of Hong Kong, China, at 1.7 per cent in 2002, was still significantly better than that in 2001.

Figure II.1. Rates of GDP growth in selected East and North-East Asian economies, 1999-2002



Sources: ESCAP, based on ADB, *Key Indicators of Developing Asian and Pacific Countries 2002*, vol. XXXIII (ADB, 2002) and *Asian Development Outlook 2002 Update* (ADB, 2002); Economist Intelligence Unit, *Country Forecasts* (London, 2002), various issues; and national sources.

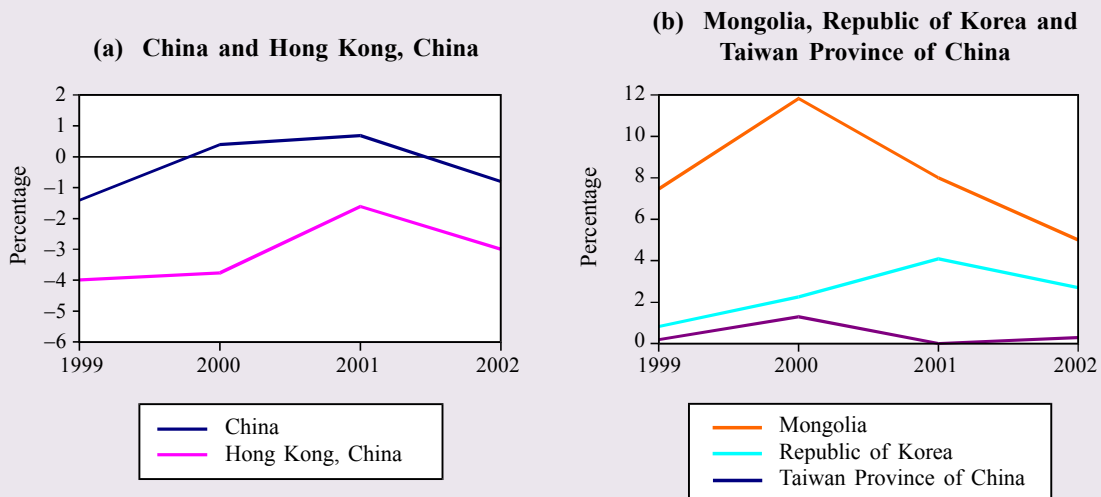
Note: Data for 2002 are estimates.

Differences in the growth rates among the economies of the subregion reflected, in part, differences in the strength of domestic demand as stimulated by expansionary government policies. All countries pursued expansionary fiscal policies in 2002, which led to widening fiscal deficits. However, domestic demand was also boosted by increased incomes in urban households in China, while both fixed investment and consumption were strengthened by higher exports in the Republic of Korea. In Hong Kong, China, domestic demand remained sluggish owing to high unemployment, falling earnings, deflation and weak consumer confidence.

Consumer prices fell by 0.8 per cent in China in 2002, after low rates of inflation in the previous two years, owing to excess supply and general price cuts following the country's membership in WTO, which resulted in, among other things, tariff reductions and increased price competition (figure II.2). In Hong Kong, China, the marked deflation in 1999-2000, which had appeared to be slowing in 2001, continued in 2002 when prices fell by 3 per cent as the macroeconomic fundamentals and property prices remained weak. Inflation moderated noticeably in the Republic of Korea, but the continued upward trend in property

China and Hong Kong, China, under deflationary pressure

Figure II.2. Inflation in selected East and North-East Asian economies, 1999-2002^a



Sources: ESCAP, based on ADB, *Key Indicators of Developing Asian and Pacific Countries 2002*, vol. XXXIII (ADB, 2002); IMF, *International Financial Statistics*, vol. LV, No. 11 (November 2002); Economist Intelligence Unit, *Country Forecasts* (London, 2002), various issues; and national sources.

Note: Data for 2002 are estimates.

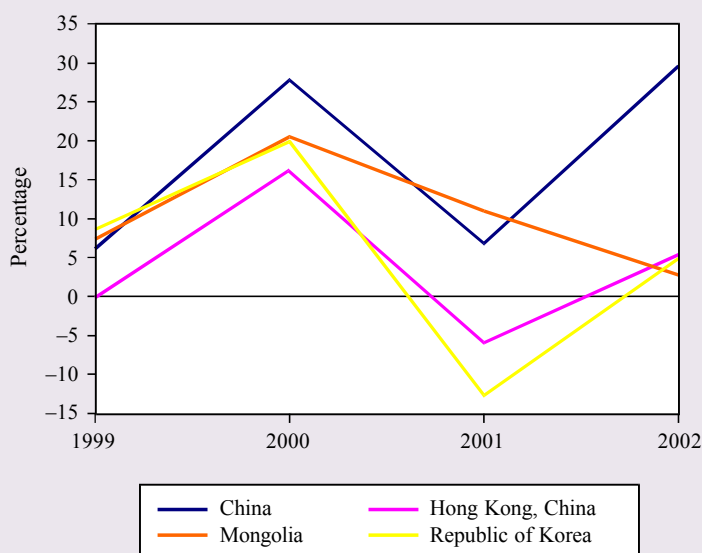
^a Changes in the consumer price index.

rentals and a price hike for agricultural products largely influenced the annual price increase rate of 2.7 per cent in 2002. In Mongolia, inflation also slowed markedly to 5 per cent in 2002, thanks to stable food prices.

China's exports soared and its robust economic performance pulled up intraregional trade

Exports in most economies of the subregion picked up gradually with a recovery in global demand, including the high-tech sector, early in the year (figure II.3). Thanks to the strong performance of China, intraregional trading activities were also buoyant. China's merchandise exports soared by almost 30 per cent year on year during the first eight months of 2002, in part reflecting greater price competitiveness. This was accompanied by a widened trade surplus as imports grew at a much slower rate than exports (figure II.4). In particular, the expansion of export growth to the United States and developing countries in Asia as well as to Hong Kong, China, more than offset a slowdown in exports to Japan and the EU. Meanwhile, merchandise exports from Hong Kong, China, went up by 2.8 per cent year on year in the second quarter of 2002

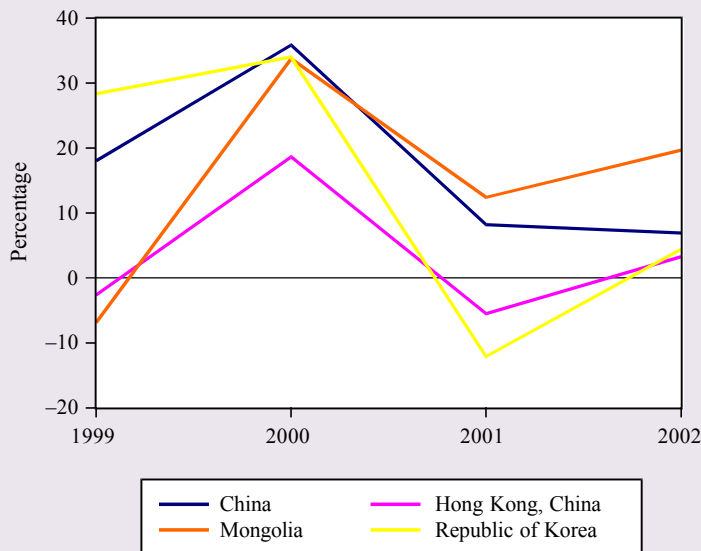
Figure II.3. Growth rates in merchandise export earnings of selected East and North-East Asian economies, 1999-2002



Sources: IMF, *Direction of Trade Statistics* (CD-ROM), January 2003; web site of the Hong Kong, China, Census and Statistics Department, <http://www.info.gov.hk/censtatd/eng/public/index2_fp.html>, 28 January 2003; Ministry of Finance and Economy, *Republic of Korea Economic Bulletin* (Seoul), various issues; and national sources.

Note: Data for 2002 refer to January-August for China and Mongolia and to January-October for the Republic of Korea.

Figure II.4. Growth rates in merchandise import spending of selected East and North-East Asian economies, 1999-2002



Sources: IMF, *Direction of Trade Statistics* (CD-ROM), January 2003; web site of the Hong Kong, China, Census and Statistics Department, <http://www.info.gov.hk/censtatd/eng/public/index2_fp.html>, 28 January 2003; Ministry of Finance and Economy, *Republic of Korea Economic Bulletin* (Seoul), various issues; and national sources.

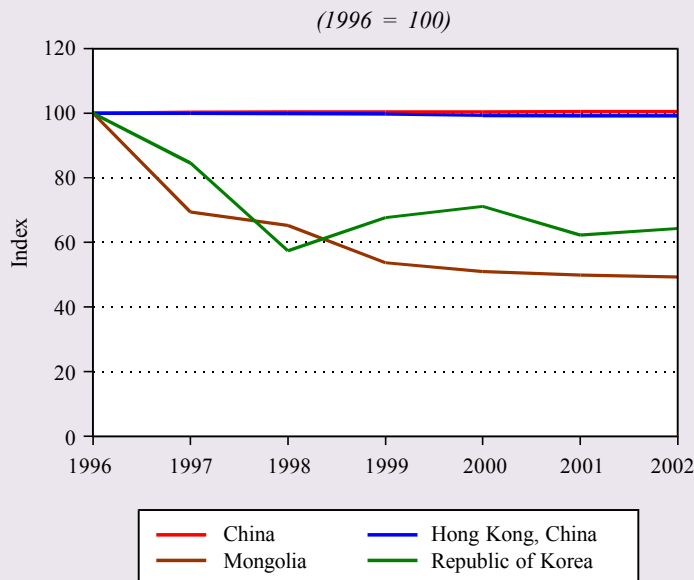
Note: Data for 2002 refer to January-August for China and Mongolia and to January-October for the Republic of Korea.

after contracting for four consecutive quarters; the expansion was mainly driven by exports to Asia and North America. Merchandise imports increased marginally in the same quarter.

The Republic of Korea's exports returned to positive growth in 2002, with a rebound in demand for high-tech products such as semiconductors and wireless communications. Exports of electronic products and passenger cars also increased, by 13 and 10 per cent respectively, in the first eight months of 2002 compared with the same period a year earlier. Strong domestic spending also drew in more imports. Mongolia's exports crept up only marginally in the first eight months of 2002 as demand for copper, its major export commodity, remained weak owing to the incomplete recovery in the external high-tech sector. A significant expansion in imports caused the Mongolian trade deficit to reach \$192 million in the first eight months of 2002.

High-tech exports rebounded in the Republic of Korea

Figure II.5. Index of exchange rates against the United States dollar of selected East and North-East Asian economies, 1996-2002



Sources: IMF, *International Financial Statistics*, vol. LV, No. 12 (December 2002); and *Far Eastern Economic Review*, various issues.

Note: Data for 2002 are estimates.

With the exception of the Republic of Korea, exchange rates were generally stable in the subregion, with the authorities in China countering upward pressures on the exchange rate resulting from the strong balance-of-payments position and Hong Kong, China, maintaining its currency board arrangement with the United States dollar (figure II.5). Relative stability in the nominal exchange rate has also been maintained in Mongolia since 2000, whereas in the Republic of Korea there was a 10 per cent appreciation in the nominal exchange rate of the won against the United States dollar in 2002.

The economic outlook for the subregion is conditioned by several

Continued strong growth, accompanied by buoyant trade, is expected in China in 2003

major risk factors, in particular, the possibility of a military conflict in the Middle East, leading to rising oil prices. Although the high price of oil appears to have had no significant impact on inflation in these economies so far, it is likely to have a negative impact on growth, especially in the countries that are almost entirely dependent on oil imports, including the Republic of Korea. China's growth prospects in 2003 are more or less the same as in 2002. Supported by a strong pace of investment expenditure, its economy is forecast to grow by 7-8 per cent in 2003, with stable or slightly lower prices. Expansionary policies are likely to be maintained by the Government, although the growing budget deficit could constrain the continued use of fiscal stimulus packages somewhat over the years. Private consumption is expected to continue to grow strongly, as is gross fixed investment, bolstered by both public sector investment and higher FDI inflows following China's entry into WTO. Inward FDI to China is projected to reach \$58 billion in 2003, boosting export production capacity. Although the volume of imports is likely to rise, a large merchandise trade surplus is also expected in 2003.

The economy of Hong Kong, China, is expected to experience an export-led recovery in 2003, with an annual growth rate of 2.5 per cent, on the back of strong growth in mainland China. The domestic recovery is expected to take time because of ongoing restructuring. Consumption growth will continue to be constrained by high unemployment and low property prices. Investment is also likely to be negatively affected by the weak property market and weak demand for fixed investment as some continuing deflation is likely to increase real interest rates.

The export-led recovery in Hong Kong, China, is likely to be modest

Mongolia's economy is expected to grow by 5.0 per cent in 2003, with robust growth in the industrial and service sectors. Key risks to economic growth are weather-related losses in the agricultural sector, while investor and donor confidence needs to be sustained in the market-oriented structural reform process.

Growth in the Republic of Korea is expected to be strong but marginally slower, at 5.3 per cent, in 2003. Export performance is expected to remain robust, underpinned by a gradual pickup in the United States and Japanese economies and an acceleration in world trade growth. However, rising uncertainties over South-North relations on the Korean peninsula and the global economy could have a dampening effect, while domestic demand will be more muted than in 2002. Notwithstanding rising oil prices, the inflation rate is likely to be somewhat offset by the slowdown in consumer spending.

Growth in the Republic of Korea will be somewhat slower in 2003 as inflation picks up with higher oil prices

GDP growth performance

The Chinese economy is estimated to have grown at the rate of 7.9 per cent in 2002, faster than the 7.3 per cent growth rate recorded in 2001 (table II.2). A robust uplift in fixed investment, together with surging export earnings, were responsible for this striking economic performance in 2002. In the first eight months of 2002, for example, merchandise exports increased by almost 30 per cent as the global economy recovered moderately. Meanwhile, sustained by strong private sector investment and continued government spending on infrastructure, gross fixed investment went up by 24.5 per cent in January-August 2002, over 5 percentage points above the growth rate in the corresponding period of 2001. In particular, investment by State-owned enterprises and foreign-funded enterprises contributed substantially to boosting fixed asset investment; the investment ratio was up to 38.5 per cent of GDP in 2002 from just under 38 per cent in the previous year (table II.3). Property investment, accounting for almost a quarter of total fixed investment, increased by another one third in the first six months of 2002, in part as a result of the low interest rates. The total value of property sales was equivalent to 7.5 per cent of GDP, and housing mortgage loans constituted almost one tenth of the total outstanding loans of all financial institutions. There is

China continues to sustain high growth, with strong expansion in fixed investment and exports

Table II.2. Selected East and North-East Asian economies: growth rates, 1999-2002

		<i>(Percentage)</i>			
		<i>Rates of growth</i>			
		<i>Gross domestic product</i>	<i>Agriculture</i>	<i>Industry</i>	<i>Services</i>
China	1999	7.1	2.8	8.1	7.5
	2000	8.0	2.4	9.6	7.8
	2001	7.3	2.8	9.9	7.4
	2002	7.9	3.0	12.6	6.8
Hong Kong, China	1999	3.4	..	..	..
	2000	10.2	..	..	..
	2001	0.6	-2.6	-2.5	1.3
	2002	1.7	..	..	..
Mongolia	1999	3.2	4.2	1.1	3.5
	2000	1.1	-14.4	1.3	18.3
	2001	1.1	-16.0	13.0	8.2
	2002	3.9	..	..	..
Republic of Korea	1999	10.9	5.4	12.8	9.9
	2000	9.3	2.0	11.9	7.9
	2001	3.0	1.4	2.6	3.6
	2002	6.1	0.5	7.0	5.2

Sources: ESCAP, based on ADB, *Key Indicators of Developing Asian and Pacific Countries 2002*, vol. XXXIII (ADB, 2002) and *Asian Development Outlook 2002 Update* (ADB, 2002); Economist Intelligence Unit, *Country Forecasts* (London, 2002), various issues; and national sources.

Notes: Data for 2002 are estimates. Industry comprises mining and quarrying; manufacturing; electricity, gas and power; and construction.

growing concern that the property market could become unstable and the Government has taken several precautionary measures, such as controlling new development projects by companies with poor financial standing.

The rising incomes of urban households boosted consumption expenditure

Consumption expenditure was also growing steadily, along with an increase in retail sales of over 10 per cent in real terms during the first nine months of 2002. As a result, the high savings rate decreased from an estimated 38.5 per cent of GDP in 2001 to 37.8 per cent in 2002. The robust consumer spending was largely due to higher urban household incomes, which rose 17.2 per cent in the first nine months of the year compared with an increase of 8.5 per cent during the same period in 2001. There was, however, a slower rate of expansion of income growth in rural areas, from 1.9 per cent in 2000 to 4.2 per cent in 2001 and further to 5.3 per cent during the first nine months of 2002. Such a pattern of earnings growth, if it persisted, could serve to widen the rural-urban income disparity.

Table II.3. Selected East and North-East Asian economies: ratios of gross domestic savings and investment to GDP, 1999-2002

<i>(Percentage)</i>				
	1999	2000	2001	2002
Savings as a percentage of GDP				
China	39.5	38.9	38.5	37.8
Hong Kong, China	30.9	32.9	31.6	33.6
Mongolia	20.0	18.0	18.0	19.0
Republic of Korea	36.9	35.6	33.3	33.7
Investment as a percentage of GDP				
China	37.5	36.1	37.9	38.5
Hong Kong, China	25.3	28.1	26.5	24.4
Mongolia	27.0	29.0	28.0	29.0
Republic of Korea	29.4	30.8	29.5	32.0
<p><i>Sources:</i> ESCAP, based on ADB, <i>Key Indicators of Developing Asian and Pacific Countries 2002</i>, vol. XXXIII (ADB, 2002) and <i>Asian Development Outlook 2002</i> (Oxford University Press, 2002); and national sources.</p> <p><i>Note:</i> Data for 2002 are estimates.</p>				

Agricultural production in China displayed the steady growth of recent years, expanding at an annual rate of 3 per cent in 2002, as it continued the transition to greater market-based orientation. Growth in industrial output showed a rising trend, reaching a rate of 12.6 per cent in 2002, compared with an average rate of just under 10 per cent a year in 2000-2001. Major sources of industrial value added were electrical products, transport equipment, especially automobiles, electronic communications equipment, such as personal computers and mobile phones, tobacco and steel products. The high-tech sector in China also recorded remarkable progress in 2002, particularly in the ICT industries, posting about 20 per cent in additional output in 2002. A third spaceship was successfully launched during the year. The growth rate in the service sector, however, slowed somewhat to 6.8 per cent in 2002, compared with an annual average of 7.6 per cent in 2000-2001. Part of the reason for this slower expansion could be the opening up of the domestic service markets after China's entry into WTO. In 2002, there were more foreign-funded companies in the fields of telecommunications, banking, insurance, retail trade and logistics than in 2001. The increased participation of well-known multinationals is expected to promote the development of China's service sector in the coming years owing to the transfer of expertise and increased competition.

***The high-tech
sector made
remarkable strides
in China in 2002***

The strong growth in exports to mainland China offset the prolonged weakness in domestic demand in Hong Kong, China

Hong Kong, China, has been recovering slowly from the global downturn that hit the subregion hard in 2001. The economy turned around to display a positive gain in total production in the second quarter of 2002; and a further gain in the third quarter. Helped by a stronger performance in exports of goods and services, the annual GDP growth rate reached 1.7 per cent in 2002, as against 0.6 per cent in 2001. Sustained strong demand from mainland China provided a substantial stimulus to merchandise exports, which also benefited from greater external price competitiveness owing to the weaker United States dollar. In contrast, domestic demand in Hong Kong, China, remained subdued; both private consumer spending and gross fixed capital formation declined from the last quarter of 2001 to the third quarter of 2002. A sharp decrease in investment spending on machinery, equipment and computer software outweighed the modest increase in building and construction, with negative effects on the productive potential of the economy. At the same time, weaknesses in the property market and corporate downsizing dampened consumer confidence with ripple effects on retail sales. The negative wealth effect resulting from the sluggish property and stock markets is expected to constrain domestic demand again in 2003.

In Mongolia, stronger growth in 2002 was led by a robust performance in manufacturing

Mongolia's economy performed better in 2002, expanding by 3.9 per cent, compared with just over 1 per cent in the previous year. The harsh winters of 2000 and 2001 caused large losses in animal herds as well as a significant decline in the output of the livestock sector, which accounted for about a quarter of GDP. Mongolia's agricultural sector has been an important source of economic growth, contributing more than half of the gains in total output during the 1990s. However, the sector is extremely vulnerable to climatic shocks, which can be only partially countered by adequate prior planning and other measures. In this context, a brighter note is that the industrial and service sectors have been contributing a greater share to overall GDP growth in recent years. Industrial output, for example, is estimated to have risen at an annual rate of 13 per cent in 2001 and an estimated 11.3 per cent year on year during the first eight months of 2002; a complementary pickup in the secondary or supportive industries is expected to push overall growth in the industrial sector higher. The best performing subsector continues to be manufacturing, registering an expansion of output by about two fifths year on year during the same period.

The growth of the Republic of Korea rebounded with strong expansionary policies

After experiencing a sharp decline in GDP growth in 2001 to 3 per cent from an average of 10.1 per cent a year in 1999-2000, the Korean economy rebounded strongly in the first quarter of 2002 and the gathering momentum resulted in an estimated expansion in aggregate output of 6.1 per cent growth for the year. The economic recovery was fuelled primarily by strong domestic demand; private consumption went up by

8 per cent year on year in the first six months of the year and fixed investment also rose very strongly in the second quarter of 2002. Monetary easing, which lowered interest rates, led to higher bank lending to households and hence stronger spending on consumer durables and housing investment. There was some concern about credit card delinquency, greater consumer debt and a potential housing price bubble in the cities, but the overall savings rate was maintained at 33.7 per cent of GDP in 2002, marginally higher than that of the previous year.

Merchandise exports also began to increase in the second quarter of 2002, led by high-tech products such as ICT manufactures, and growth in the first 10 months of 2002 is estimated at 4.9 per cent. The Republic of Korea was the largest producer of mobile telephones in the world, producing 112 million in 2002, of which 96 million were destined for export. Export earnings on ICT products maintained their robust growth, despite pervasive concerns over the delay in the economic recovery of the developed countries.

The low interest rate environment and robust economic recovery helped both the financial and corporate sectors to improve profitability, which was one of the goals of the ongoing economic restructuring. In turn, the improved business climate was reflected in a noticeable rise in the investment ratio to 32 per cent of GDP in 2002, from 29.5 per cent a year earlier. The industrial and service sectors expanded by 7 and 5.2 per cent respectively in 2002, reversing the declining trend in the growth rates of those sectors during the period 1999-2001. However, the agricultural sector, with a relative share of just 5 per cent of GDP in 2000, continued on a declining growth trend, expanding by only 0.5 per cent in 2002.

Inflation

In East and North-East Asia in 2002, inflation slowed in the Republic of Korea and Mongolia, while China, and Hong Kong, China, registered some measure of deflation (table II.4). Consumer prices in China declined by 0.8 per cent in 2002 after low or negative inflation in the period 1999-2001, the main reasons being oversupply and fierce price competition. Along with China's entry into WTO, large reductions in import tariffs were implemented at the beginning of 2002. This in effect forced local producers to cut prices in order to compete with imports and, together with the excess production capacity for most consumer products, contributed to downward pressure on consumer prices. According to the Domestic Trade Information Center, among more than 600 different industrial products, no item was in short supply. Of the various product categories that make up the consumption basket, only the costs of recreation, education and residential housing went up; the prices for other items,

***Consumer prices
in the subregion
remained in check,
or even declined***

Table II.4. Selected East and North-East Asian economies: inflation and money supply growth (M2), 1999-2002

	(Percentage)			
	1999	2000	2001	2002
Inflation^a				
China	-1.4	0.4	0.7	-0.8
Hong Kong, China	-4.0	-3.8	-1.6	-3.0
Mongolia	7.5	11.8	8.0	5.0
Republic of Korea	0.8	2.2	4.1	2.7
Money supply growth (M2)				
China	14.7	12.3	15.0	19.1 ^b
Hong Kong, China	8.3	9.3	-0.3	-0.9 ^c
Mongolia	31.6	17.6	27.9	34.1 ^b
Republic of Korea	27.4	25.4	13.2	10.9
<p><i>Sources:</i> ESCAP, based on ADB, <i>Key Indicators of Developing Asian and Pacific Countries 2002</i>, vol. XXXIII, (ADB, 2002); IMF, <i>International Financial Statistics</i>, vol. LV, No. 11 (November 2002); Economist Intelligence Unit, <i>Country Forecasts</i> (London, 2002), various issues; and national sources.</p> <p><i>Note:</i> Data for 2002 are estimates.</p> <p>^a Changes in the consumer price index. ^b January-August. ^c January-July.</p>				

such as transport and communications services, household facilities and services and clothing, declined in 2002. Consecutive increases in grain production in the previous four years also helped to keep food prices stable. However, strong domestic demand, boosted by rapid economic growth in recent years, served to contain the fall in prices. As producer prices have started to stabilize recently and the Central Bank has begun to increase the money supply, the rate of deflation in China is expected to slow to approximately 0.5 per cent in 2003. In particular, interest rates were cut in February 2002, for the first time since 1999, in order to stimulate sustained economic growth.

Falling property prices in Hong Kong, China, have been responsible for over half of the decline in consumer prices

The rate of deflation accelerated to 3 per cent in Hong Kong, China, in 2002 after having shown some signs of stabilizing in 2001, when the fall in consumer prices was 1.6 per cent; deflation had averaged 3.9 per cent annually in 1999-2000. Among the main contributing factors to falling prices were weaknesses in the property market. According to an official source, falling property prices were responsible for 57 per cent of the deflation observed over the last four and a half years. The influence of subdued demand was evidenced mainly by a rapid fall in the prices of

non-tradable services such as education and telecommunications. Import prices also contributed to the deflation, with the average cost of imports decreasing by 4.4 per cent year on year in the first nine months of 2002; such a decline, in turn, was influenced by deflationary pressure from mainland China.

Countermeasures taken by the Government, such as reductions in property rates and utility charges to ease the financial burden on households affected by the economic slowdown, also contributed to lower prices. As wage increases are expected to remain moderate, consumer prices are projected to keep falling in 2003 but at the slower rate of 1.5 per cent. The exchange rate of the Hong Kong dollar is pegged to the United States dollar. Such an arrangement, which has been held partly responsible for the continued deflation, does not allow much room for policy flexibility. The loosening of monetary policy in the United States has meant that interest rates have also remained low in Hong Kong, China, but domestic demand remains weak.

Mongolia experienced double-digit consumer price inflation of 12 per cent in 2000 owing to the effects of weather-related shortages in food supplies and higher public utility tariffs, as well as a 25 per cent general increase in civil service wages. However, the inflation rate has been brought down to single digits since 2001, as both the exchange rate and domestic food prices were relatively stable. Food prices, in particular, had fallen, thanks to the increased availability of meat and milk products during the summer, and this helped to reduce inflation to 5 per cent in 2002. Although recent drought conditions may result in higher food prices in the period ahead, Mongolia's inflation in 2003 is expected to remain at roughly the same rate as in 2002. Broad money supply (M2) expanded very sharply in 2001-2002, but without evidently worsening the inflation picture. However, the continuation of the high rates of monetary growth could worsen the outlook for consumer prices.

*Consumer prices
were in check
and food prices
stabilized in
Mongolia*

The Republic of Korea succeeded in lowering the rate of inflation to 2.7 per cent in 2002, from 4.1 per cent in 2001, by stabilizing monetary growth and carrying out further market deregulation that encouraged the entry of, and hence competition from, more foreign companies, particularly in the service sector. Nevertheless, the within-year trend in consumer prices in 2002 indicated some increase in inflationary pressure as the economy continued to expand. More recently, higher food prices, following a weather-related drop in agricultural production, and rising housing costs, contributed to some pickup in inflation towards the end of the year. The strong won, however, has limited the impact of higher international oil prices on non-food prices so far. Inflation is expected to increase slightly to 3.3 per cent in 2003, along with higher prices for oil and raw materials, increased unit labour costs and a hike in public service fees.

*The stronger
won has mitigated
the impact of
higher oil prices in
Republic of Korea*

Foreign trade and other external transactions

External trade

Exports from China, particularly of high-tech products rebounded strongly in 2002

After slowing for most of 2001, China's export earnings went up sharply in 2002. During the first eight months of the year, merchandise exports expanded by nearly 30 per cent year on year, compared with less than 7 per cent in 2001 (table II.5). During the same period, merchandise imports increased by almost 7 per cent, slower than the over 8 per cent growth in 2001 (table II.6), but import spending seemed to have picked up considerably in the latter half of the year. Exports of high-tech products went up particularly rapidly, at the annual rate of 44 per cent in the first six months of 2002, and have constituted a growing share of the country's total exports as more multinational companies move the production of technology-intensive goods to China to take advantage of low production costs.

The contribution of foreign-funded enterprises to export growth was particularly important

China has become the sixth largest country in the world in terms of foreign trade and is becoming more integrated into the world economy with an increasing share of overseas markets. The remarkable increase in China's trade dependence is attributable to trade liberalization in the run-up to WTO membership as more domestic firms become engaged in international trading activities. The non-State sector was mainly responsible for the rapid growth in trade achieved in 2002 and the contribution of foreign-funded enterprises was particularly important. Total exports by

Table II.5. Selected East and North-East Asian economies: merchandise exports and their rates of growth, 1999-2002

	Value (millions of US dollars)	Exports (f.o.b.)			
		Annual rate of growth (percentage)			
		1999	2000	2001	2002
China ^a	266 140	6.1	27.8	6.8	29.6
Hong Kong, China	190 069	-0.1	16.1	-6.0	5.4
Mongolia ^a	455	7.4	20.5	11.0	2.7
Republic of Korea ^b	150 439	8.6	19.9	-12.7	4.9

Sources: IMF, *Direction of Trade Statistics* (CD-ROM), January 2003; web site of the Hong Kong Special Administrative Region, Census and Statistics Department, <http://www.info.gov.hk/censtatd/eng/public/index2_fp.html>, 28 January 2003; Ministry of Finance and Economy, *Republic of Korea Economic Bulletin* (Seoul), various issues; and national sources.

^a Data for 2002 refer to January-August.

^b Data for 2002 refer to January-October.

Table II.6. Selected East and North-East Asian economies: merchandise imports and their rates of growth, 1999-2002

	Value (millions of US dollars)	Imports (c.i.f.)			
		Annual rate of growth (percentage)			
		1999	2000	2001	2002
China ^a	243 613	18.1	35.8	8.2	6.9
Hong Kong, China	201 444	-2.7	18.6	-5.5	3.3
Mongolia ^a	661	-6.9	33.8	12.4	19.7
Republic of Korea ^b	141 098	28.4	34.0	-12.1	4.5

Sources: IMF, *Direction of Trade Statistics* (CD-ROM), January 2003; web site of the Hong Kong Special Administrative Region, Census and Statistics Department, <http://www.info.gov.hk/censtatd/eng/public/index2_fp.html>, 28 January 2003; Ministry of Finance and Economy, *Republic of Korea Economic Bulletin* (Seoul), various issues; and national sources.

^a Data for 2002 refer to January-August.
^b Data for 2002 refer to January-October.

those enterprises were up by about 24 per cent year on year in the first nine months of the year, accounting for more than half of the total earnings on exports. By contrast, State-owned firms were able to increase their exports by just over 7 per cent, while their spending on imports increased by almost 8 per cent year on year in the first nine months of 2002.

The three major categories of China's merchandise exports in 2002, accounting for 73 per cent of the total export value during the first nine months of 2002, were machinery and electrical appliances, with a relative share of almost 35 per cent of the total, electrical machinery and equipment, nearly 20 per cent, and textiles, about 18 per cent. Although exports of technology-intensive goods were growing fast, exports of traditional labour-intensive products tended to dominate the merchandise trade surplus. However, China has a structural trade deficit in some key products such as oil, minerals, chemicals and plastics, as well as in the import-inducing and export-related sectors, such as electronics. As the economy grows in the future, these structural trade deficits are likely to widen and an eroding trade surplus is likely to be a result. However, with exports expanding faster than imports, the trade surplus soared to about \$25 billion in the first 10 months of 2002; this was two fifths higher than the level in 2001. The current account surplus as a percentage of GDP expanded from 1.5 per cent in 2001 to an estimated 2.2 per cent in 2002 (table II.7).

*Nevertheless,
exports of
traditional labour-
intensive products
dominate China's
merchandise trade
surplus*

Table II.7. Selected East and North-East Asian economies: budget and current account balance as a percentage of GDP, 1999-2002

	(Percentage)			
	1999	2000	2001	2002
Budget balance^a as a percentage of GDP				
China	-2.9	-2.8	-2.6	-3.0
Hong Kong, China	0.8	-0.6	-5.2	-6.3
Mongolia	-11.4	-7.0	-4.7	-4.2
Republic of Korea	-3.0	1.4	1.3	0.3
Current account balance as a percentage of GDP				
China	2.1	1.9	1.5	2.2
Hong Kong, China	7.3	5.5	7.2	7.1
Mongolia ^b	-14.1	-15.8	-15.9	-14.0
Republic of Korea	6.0	2.7	2.0	1.5

Sources: ESCAP, based on ADB, *Key Indicators of Developing Asian and Pacific Countries 2002*, vol. XXXIII (ADB, 2002) and *Asian Development Outlook 2002* (Oxford University Press, 2002); IMF, *International Financial Statistics*, vol. LV, No. 11 (November 2002); Economist Intelligence Unit, *Country Forecasts* (London, 2002), various issues; and national sources.

Note: Data for 2002 are estimates.

^a Excluding grants.
^b Excluding official transfers.

Sales to other economies in the region accounted for the revival in exports from Hong Kong, China

After declining for four consecutive quarters, the export performance of Hong Kong, China, which had begun to deteriorate sharply in the first half of 2001, strengthened in the second quarter of 2002, and merchandise exports were up by 5.4 per cent in 2002 after a decline of 6 per cent in 2001. The turnaround was largely due to stronger exports to economies in Asia and the Pacific. In particular, total merchandise exports to such East Asian countries as mainland China, the Republic of Korea, Malaysia, Thailand, the Philippines and Singapore, picked up remarkably to reach double-digit growth year on year in the third quarter of 2002. Exports to Japan, which had been declining steadily for some time, reverted to positive growth in the third quarter of 2002, while those to North America and the EU were helped by improved relative price competitiveness. Service exports were also buoyant, with a surge in inbound tourism and in offshore trade and transport services in 2002.

The current account surplus as a percentage of GDP remained steady in Hong Kong, China

Imports of goods, which had declined by over 5 per cent in 2001, began to pick up in 2002, stimulated by stronger domestic demand and an increase in re-exports; import spending recorded positive growth over 3 per cent in 2002. Imports of services also rose moderately. Hong Kong, China's current account surplus is estimated to have been

7.1 per cent of GDP in 2002, substantially similar to the surplus of 7.2 per cent in 2001. However, as external demand in key export markets appears to have picked up faster than domestic demand, the trade deficit is projected to narrow and the current account surplus to widen in the immediate future.

Mongolia's export receipts depend heavily on global demand conditions and the terms of trade commanded by its principal export commodities, copper, gold, cashmere products, hides and skins, meat and other animal products. The outlook for copper exports worsened markedly as the slowdown in high-tech industries depressed world prices for copper. Meanwhile, the demand for finished cashmere in major industrial countries, such as the United States and Japan, has also slowed. However, the impact of those adverse developments on total export earnings has been moderated by a rise in the price of gold. Although merchandise exports increased by only 2.7 per cent year on year in the first eight months of 2002, Mongolia's export earnings are projected to have increased by about 20 per cent in 2002 as a whole on the back of higher gold prices. The United States and China are the principal export destinations and are likely to have accounted for approximately 40 and 34 per cent of Mongolia's export earnings in 2002.

*Mongolia's
merchandise exports
benefited from the
rise in the price
of gold*

Merchandise imports grew remarkably, by almost 34 per cent in 2000, before moderating to a 12.4 per cent annual growth rate in 2001. However, in the first eight months of 2002, spending on imports expanded by nearly 20 per cent year on year owing to higher imports of food, textiles, machinery and equipment, and spare parts. The Russian Federation is the principal source of imports for Mongolia, with an estimated 30 per cent share in 2002, followed by China, at around 18 per cent. Mongolia's trade deficit is projected to have widened in 2002, registering \$192 million during the first eight months of the year or some 64 per cent higher than the trade shortfall in the same period of 2001. The ratio of the current account deficit to GDP is, however, expected to have improved somewhat in 2002, to 14 per cent from almost 16 per cent in 2001, reflecting the improved performance of GDP.

Merchandise exports from the Republic of Korea decreased sharply in 2001, by over 12 per cent, after robust growth of almost 20 per cent in 2000. However, there were signs that a revival was under way in 2002, and exports were up by almost 5 per cent year on year in the first 10 months of the year. Strong sales to China contributed to the export recovery, and the Chinese market accounted for almost 14 per cent of total exports in 2002, up from 12 per cent in 2001. Exports to Japan, however, fell by another 7 per cent in the first eight months of 2002 from their level a year earlier, following a 20 per cent drop in 2001 as a whole. Exports to the United States were up by 4 per cent in the same period of 2002 compared with a year earlier, following an 18 per cent decline in

*China has become
an important
market for exports
from the Republic
of Korea*

2001 as a whole. Notably, growth in merchandise exports accelerated from 5 per cent in the second quarter of 2002 to an estimated 17 per cent in the third quarter compared with a year earlier. The export growth reflected a rebound in exports of such high-tech goods as semiconductors and wireless communications, particularly to China; after a 24 per cent decline in 2001, exports of electronic products were more than 13 per cent higher in the first eight months of 2002 from a year earlier. Exports of passenger cars increased at an annual rate of 10 per cent over the same period following 3 per cent growth in 2001, boosted by the relatively strong demand for motor vehicles in the United States, although sales to Europe were sluggish.

Strong consumer goods imports narrowed the trade and current account surpluses in the Republic of Korea

Merchandise imports, which had fallen by around 12 per cent in 2001 after remarkable growth of 34 per cent in 2000, increased by 4.5 per cent year on year in the first 10 months of 2002. Strong domestic spending raised the value of imports in the third quarter, by 15 per cent from the level a year earlier, following 8 per cent annual growth in the second quarter and an annual decline of more than 11 per cent in the first quarter (all on a year-on-year basis). Import spending on consumer goods went up by 22 per cent in the first eight months of 2002 compared with the same period in 2001, after 3 per cent growth in 2001 as a whole. The growth in imports reduced the trade surplus slightly to \$9.6 billion in the first eight months of 2002 from \$9.7 billion a year earlier. In addition, higher net service payments and transfer outflows raised the service trade deficit to \$6 billion in the first eight months of 2002 from \$2.9 billion a year earlier. The lower trade surplus and the higher net payments for services reduced the current account surplus to \$3.5 billion in the first eight months of 2002 from \$6.8 billion a year earlier. The external current account surplus is estimated to have reached about \$7 billion, or 1.5 per cent of GDP, in 2002, down from \$8.6 billion, or 2 per cent of GDP, in 2001. The surplus is expected to go down further in 2003 because of a decline in the merchandise trade surplus, as steady growth in domestic demand is likely to increase imports faster than exports.

Capital flows and exchange rates

Increased FDI in China boosted productive capacity and supported the strong export performance

China's entry into WTO has spurred further inward foreign investment, which, in turn, has contributed greatly to expanding the country's productive capacity and strong export performance. As noted earlier, foreign-funded companies now account for over 50 per cent of total exports, up from 40 per cent five years earlier. Gross inflows of FDI reached \$48 billion in the first 11 months of 2002, compared with \$42 billion in the same period a year earlier, while new investment commitments amounted to \$77 billion, an increase of more than 27 per cent over the previous year. In contrast, the downturn in global equity markets limited new offshore listings of Chinese companies in the first 11 months

of 2002, while foreign bank exposure in China has been on a declining trend. No new international bonds were issued in the first 10 months of 2002, although higher investor confidence is reflected in the narrowing of the spread on the dollar-denominated sovereign bond issue of May 2001, to 90 basis points in November 2002 from 140 basis points at issue. The total external debt, which fell to \$170 billion at the end of 2001 from \$174 billion at the end of 2000, had fallen further to \$160 billion by August 2002. Debt service amounted to less than 5 per cent of the value of exports of goods and services and China's net debt repayments have also been quite moderate. Meanwhile, rising per capita incomes have meant that both new commitments and net disbursements from the World Bank have shown a downward trend over the past few years. China's official foreign reserves increased to \$257.2 billion in August 2002 from \$215.6 billion at the end of 2001. The country has maintained a "managed float" exchange rate regime since 1994, with the yuan renminbi fluctuating in a narrow band of around 8.27 to the United States dollar. The strong balance-of-payments position has generated some upward pressure on the exchange rate; the pressure has been countered by the authorities and little change is expected in the near term.

Hong Kong, China's net FDI outflows reached \$1.3 billion in the first quarter of 2002, compared with a net inflow of \$7.6 billion a year earlier. The large net inflows in 2001 preceded China's entry into WTO and coincided with a sharp rise in foreign investment commitments in that country, suggesting that funds were moved to Hong Kong, China, to position investors for the opening of China's markets under WTO, resulting in the net outflow in 2002. Share issues by red-chip companies in Hong Kong, China, in 2001 and 2002 contributed to the large foreign equity inflows, which were reversed when the funds were remitted to China. A higher level of direct equity investment in China, a weak stock market and continued reduction in foreign bank lending activity suggested that capital outflows had partially offset the current account surplus. Official foreign exchange reserves were up slightly to \$112.3 billion in August 2002 from \$111.2 billion in December 2001. Hong Kong, China, maintains a currency board system with the United States dollar, to which the Hong Kong dollar is pegged; this long-standing arrangement is likely to continue in the foreseeable future, given the ample amount of official reserves.

The Republic of Korea's economic rebound and relatively low interest rates available in international capital markets led to higher external borrowings, reversing the large debt repayments that had been a drain on the capital account over the past few years. Private creditors were the main sources of new lending, while official creditors continued to receive net repayments. In particular, foreign banks registered a sharp rise in their exposure in 2002 after being the recipients of net repayments

In contrast to mainland China, Hong Kong, China, experienced net outflows of FDI

External borrowing from private creditors increased in the Republic of Korea

in each of the previous five years. The bulk of new lending was in short-term trade and inter-bank credits. New international bond issues went up to \$5.3 billion in the first nine months of 2002, from \$1.1 billion a year earlier, as the decline in spreads over the past year lowered borrowing costs for Korean entities, thus encouraging them to tap the international bond market. For example, the spread on the 10-year sovereign issue maturing in April 2008 fell to 110 basis points in September 2002 from 190 basis points a year earlier. By contrast, in 2001 IMF received the outstanding balance of \$5.7 billion of the funds provided under the 1997 standby programme. The World Bank, which has made no new commitments since the Structural Adjustment Loan at the onset of the financial crisis in 1997, continued to receive small net repayments. Official export credit agencies, however, appeared to have been a source of small net lending again in 2002, with increased trade credits following net inflows of less than \$0.5 billion in 2001.

The large equity inflows of the past few years have reverted to outflows in the Republic of Korea

By contrast, foreign investors retreated from the Korean stock market, with net outflows of portfolio equity of \$3 billion in the first eight months of 2002, compared with net inflows of almost \$10 billion in 2001. Gross inflows of FDI also dropped to \$1 billion in the first eight months of 2002 from \$2.7 billion a year earlier, reflecting in part the weakening in investor sentiment globally. New investment commitments, however, rose to \$6.7 billion in the first eight months of 2002 from \$5.7 billion a year earlier. Total external debt amounted to \$130.4 billion at the end of November 2002, up from \$117.7 billion at the end of 2001, while debt-service payments due in 2002 were equivalent to about 8 per cent of exports of goods and services. Official foreign exchange reserves increased to \$116.5 billion in August 2002, or about 13 per cent higher than the level in 2001. The exchange rate of the won has been under some upward pressure given the weakening of the United States dollar and the continuing current account surplus. In fact, the won had appreciated by about 10 per cent relative to the United States dollar by the end of 2002, compared with its value a year earlier. Strong export performance and a healthy foreign exchange reserve position are expected to support the stability of the won exchange rate in 2003.

Mongolia's reliance on official foreign capital inflows continues to be heavy

Mongolia relies on private capital markets to a limited extent and is thus less exposed to the risks stemming from a possible drying-up of commercial loans. The country is heavily dependent on foreign aid and official loans to cover a large proportion of the current account deficit of around 14-16 per cent of GDP in recent years. Such a shortfall is expected to remain stable with the help of the existing pipeline of concessional external loans in 2002. The total amount of external debt since 1991, which consists mainly of government debt secured on concessional terms, declined to 83 per cent of GDP in 2001; the debt-service ratio has so far remained manageable. However, the ongoing

heavy reliance on foreign capital inflows to finance a large current account deficit makes the economy highly vulnerable to changes in donor and investor sentiment. Mongolia's FDI is expected to decline in the near future, reflecting the worsening prospects for the copper and cashmere industries. However, the investment inflows associated with the recent privatization of the Trade and Development Bank are projected to have been of the order of at least \$12 million, or 1 per cent of GDP, in 2002. The decline in new FDI inflows may be exacerbated by a reduction in official loan disbursements if the Government does not take timely action to bring its reform programme back on track. In order to maintain donor confidence and attract inward FDI, the pursuit of sound macroeconomic policies would need to be complemented by prudent external debt management and market-friendly reforms.

Mongolia maintained a virtually stable exchange rate between its currency and the United States dollar between late 2000 and mid-2002. Upon IMF advice and in the light of weakening export growth and a worsening global environment, greater exchange rate flexibility has been introduced to encourage export-led investment and growth; in particular, beginning in July 2002, the buy-sell margin around the intervention rate was widened and consideration was being given to setting the intervention rate on a daily, rather than a weekly, basis.

Key policy issues

There were higher fiscal deficits in some economies, owing in part to the various fiscal stimulus measures taken in 2002 (table II.7). Notwithstanding a significant increase in public spending in connection with the World Cup and the Asian Games, the Republic of Korea was the only economy in the subregion to run a budget surplus in 2002; at 0.3 per cent of GDP, however, it was much smaller than the average surplus of around 1.4 per cent of GDP a year in 2000-2001. Lower public expenditure, along with increased revenue from strong economic growth, can be expected to improve the budget position in the Republic of Korea in 2003-2004, thus facilitating a further reduction in the country's relatively low stock of public debt, which stood at 19 per cent of GDP at the end of 2000.

Public expenditure in China was up by almost 18 per cent in the first half of 2002 compared with the same period a year earlier, while fiscal receipts increased by just over 9 per cent in the same period year on year. China's budget deficit expanded to 3 per cent of GDP in 2002 from 2.6 per cent in the previous year. In Hong Kong, China, weak economic performance and the introduction of some tax relief measures are projected to make the budget deficit swell to 6.3 per cent of GDP in 2002. This high and widening level of fiscal shortfall has been a matter

The pursuit of expansionary fiscal policies created pressures on the fiscal balance in some parts of the subregion in 2002

of concern; the deficit was equivalent to 5.2 per cent of GDP in 2001 and there was an approximate fiscal balance on average for 1999 and 2000. Mongolia managed to reduce the budget deficit to 4.2 per cent of GDP in 2002 from 4.7 per cent in 2001. However, lower revenues from the copper mining and cashmere sectors may necessitate further cuts in public expenditure in 2003-2004 to achieve fiscal sustainability.

Contingent liabilities could raise the public debt ratio considerably in China

China's public debt has increased significantly in recent years as a result of continued fiscal pump-priming. As a percentage of GDP, public debt is estimated to have remained below 20 per cent, which is low in comparison with the corresponding ratios in other countries in the region. However, the ratio could be much higher especially with the inclusion of contingent liabilities of the public sector; for example, a high level of NPLs among State-owned banks, and the need for increased contributions to the country's pension system in the coming years to support a large number of urban retirees, and for higher funding for social safety net arrangements in view of the expected large increase in the number of unemployed workers. Such contingent liabilities could narrow the scope and room for fiscal manoeuvre, although the overall level of public debt in China is believed by most experts to be sustainable over the medium and long terms given the country's substantial stock of convertible assets. The Government is moving to reform China's taxation system to broaden, deepen and strengthen its revenue base; divestiture of State-owned assets could also generate substantial funds to meet expected future obligations.

China has made the largest single contribution of any country to global poverty reduction in the past two decades

China's achievement in lifting hundreds of millions of people out of absolute poverty in the past 20 years has been extremely impressive, with sustained high rates of economic growth being a major underpinning force. The country has thus made the largest single contribution to global poverty reduction of any country in the last two decades. Beyond income growth, market-oriented reforms have dramatically improved the dynamism of both the rural and the urban economies and contributed to a substantial improvement in the indicators of human development.

Nevertheless, formidable challenges remain. It is estimated by the World Bank that some 200 million people, many in remote and resource-poor areas in the western and interior regions, still live on less than \$1 per day. They often lack adequate access to clean water, arable land or health and education services. Regional and rural-urban income inequalities and the emergence of vulnerable urban groups have been a matter of policy concern. In parallel with its agenda for economic reform and growth, the Government has been pursuing the Western Region Development Strategy for some years to assist the 12 western and inland provinces, where per capita income is less than half that of the more developed coastal provinces and illiteracy is higher and where the largest proportion of China's very poor resides.

Since agriculture will continue to be the mainstay of the rural economy for some time to come, agricultural research and technology development geared to the specific needs of the typically poor western areas are viewed as an imperative. Environmental protection and sustainable development should also be important goals for both economic development and poverty reduction in China. There are interrelationships between poverty and environmental degradation, specifically as regards severe soil erosion, deforestation and desertification in rural areas. Promoting clean coal energy sources and technologies in urban areas could make a considerable contribution to reducing water and air pollution.

As China continues its economic restructuring and enterprise reform processes, the number of persons in unemployment and disguised unemployment is likely to rise, particularly in urban areas, at least in the short term and possibly the medium term. Official statistics showed that the registered number of unemployed workers in urban areas was 7 million at the end of June 2002, or about equal to the number at the beginning of the year, and the official unemployment rate, at 4 per cent, was below the Government's target of 4.5 per cent in 2002. However, many analysts believe that the actual unemployment rate is likely to be higher. Meanwhile, a variety of responsive measures have been introduced to help laid-off workers to obtain new jobs. The Government has also indicated that it would help to promote the development of labour-intensive enterprises with the market potential to absorb the unemployed.

Since the current level of unemployment is relatively high in Hong Kong, China, the issue of employment creation is among the top priorities on the Government's agenda. Measures imposed in response include encouraging private organizations to provide more employment opportunities, improving the business environment and facilitating market activities. At the same time, improvements in job training and retraining schemes and career advisory services are being carried out to ensure the greater employability and adaptability of workers seeking job opportunities. Other areas of policy focus are the maintenance of institutional strength that is conducive to market development; some reduction in the size and involvement of the Government; the promotion of closer economic ties with mainland China; the upgrading of human resources; the establishment of high-quality infrastructure, the development of high value added sectors and activities; and the stabilization of the property market.

Although a vibrant private sector is emerging in Mongolia, market forces have increased somewhat the disparities in the living standards between the rural and urban populations and the income gap between the haves and the have-nots. According to the World Bank, 23 per cent of the population lives in extreme poverty. The urban poor are in an especially vulnerable position, given the high costs of housing and of staple food.

Employment generation is at the top of the policy agenda in Hong Kong, China

Mongolia is also dealing with widening income disparities in its market-based transition process

Access to schooling and health services has apparently declined, particularly among the poor. While key social indicators are good in comparison with other countries at a similar stage of development and generally have not deteriorated, large differences have nevertheless emerged between the rural and urban sectors and between low- and high-income households. According to the 2000 census, 95.4 per cent of urban children aged 10-14 attended schools, while the rate was only 84.8 per cent for children living in rural areas. There are also signs that the quality of health and education may have deteriorated. With the support of multilateral institutions, the Government of Mongolia has drawn up rural development and poverty reduction strategies for which funding will be sought in 2003.

Strengthening the financial sector is another important policy issue for China

It was reported in June 2002 that the NPLs of the four State banks in China amounted to 23 per cent of total loans and 17 per cent of GDP. Progress in addressing the problem was first made in 1999 and 2000, when NPLs worth 1.4 trillion yuan renminbi (\$169 billion) were transferred to asset management companies. After the transfer, there was a reduction by banks of 90.7 billion yuan renminbi (\$11 billion) in the NPLs left on their books in 2001 and a further 36.9 billion yuan renminbi (\$4.5 billion) between December 2001 and June 2002. The Government expects banks to reduce their NPL ratio to 15 per cent of total loans by 2006, when the banking sector is fully opened to foreign competition. The reduction is to be achieved through both the recovery of existing NPLs and the improved quality of new lending. The loan recovery process, however, has been slow and is becoming increasingly difficult as it is hampered by the lack of property markets and an underdeveloped legal system, among other things. The large amount of NPLs and the fragility of the banking sector in China are major factors in the official decision to pursue capital account liberalization gradually and cautiously.

Although NPLs are comparatively high in China, there is little likelihood of a systemic crisis and liquidity remains ample

There are no plans at present to transfer more NPLs to the asset management companies. This, however, has its risks because the amount of NPLs could rise rapidly with slower economic growth. Banks' credit analysis remains weak and a further acceleration in lending could result in higher NPLs. In addition, NPLs remain a heavy burden even if the ratio is reduced to 15 per cent, limiting the banks' ability to compete when banking business in the local currency is opened to foreign banks. The Government will also need to strengthen its supervisory functions significantly as an essential step towards maintaining financial stability and preventing future financial crises. While domestic banks' NPLs are large by international standards, the prospect of an immediate systemic crisis is unlikely, given the ample liquidity within the banking system. Confidence in the Government as well as limited investment alternatives have prompted residents to continue to deposit large amounts of savings in State banks. Meanwhile, domestic banks are also making concerted efforts

to improve operational efficiency and asset quality, including through the closure of most of their loss-making branches in rural and less developed areas, and streamlining of the workforce.

Although restructuring efforts in the corporate and banking sectors in the Republic of Korea have resulted in greater economic flexibility and adaptability of firms, further improvements can still be made in the areas of corporate governance, transparency and accountability. The restructuring of the financial sector is one of the key issues that the country is facing. In order to improve the Korean banking sector, the Government is pressing ahead with the sale of its shares in nationalized banks, for example, a merger agreement between Hana Bank and Seoul Bank was signed in August 2002; Seoul Bank had been nationalized in 1998 after the Government injected 5.6 trillion won in public funds into it. The process is expected to imply further bank consolidation, which will serve to bolster the competitiveness of domestic banks. The Government has also resolved to step up the pace and complete bank privatization over the next three years as faster economic growth has led to improved profitability in the banking sector. In the insurance industry, comprising 42 companies, 9 companies with solvency margins of less than 100 per cent have been restructured. To date, 20.8 trillion won of public funds have been injected into the insurance industry. NPLs of commercial and specialized banks fell to 2.4 per cent of total loans at the end of June 2002, from 8 per cent a year earlier. However, those in the non-bank sector remained relatively high, at 10 per cent of total loans as at June 2002, although there was some progress in reducing the ratio over the past year. The NPL ratio for the financial system as a whole stood at 4.2 per cent in mid-2002. With regard to the issues of rising consumer debt and credit card delinquency, measures have been introduced to make financial institutions more cautious about lending and managing consumer loans.

Another important policy priority in the Republic of Korea is to ensure a healthy and profitable corporate sector by expediting the exit of the remaining non-viable companies and by subjecting those corporations that are distressed, but viable, to workouts involving debt write-downs and operational restructuring. As China's entry into WTO will increase competitive pressures and open up new opportunities, Korean corporations will need to adjust and continue to move up the export ladder in terms of quality, technological sophistication, innovation and cost competitiveness.

Banking sector reform is an important policy agenda in Mongolia. Among the major areas for policy focus are strengthened bank supervisory capabilities, the restructuring of State-owned banks, the reform of non-financial public enterprises, the ongoing introduction of an open trade and investment system, reinforcement of a market-oriented regulatory framework and progressive reduction of public sector arrears along with the steady removal of indirect subsidies.

The Republic of Korea needs to go further in financial and corporate restructuring

Market-based reforms are also needed in the banking sector in Mongolia