Economic and Social Survey of Asia and the Pacific 2022

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Economic Policies for an Inclusive Recovery and Development
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SUMMARY

ASIA-PACIFIC SURVEY 2022
Building forward fairer

High levels of inequality constrain economic growth, generate political and socioeconomic instability.

Building a fairer future – ensuring an inclusive recovery from the pandemic and building an inclusive development path – is an imperative.
Economic growth in Asia and the Pacific has been the fastest in the world in the last decade. The region’s economic success, however, has not been enjoyed by all.

The failure of individual countries and areas to grow together at all income and social levels, as well as along urban-rural and gender lines, has led to scarring effects, especially during the pandemic, which brings the issue of inequality and fairness to the fore.

These long-term scars are already setting the 2030 development agenda back.

For countries with low levels of inequality, especially low-income countries, some increase in inequality is integral to the effective functioning of a market economy.

Nevertheless, increases in inequality, beyond a certain threshold and degree of persistence, encourage rent-seeking, lower economic growth and deprive the poor of the ability to stay healthy, acquire education and accumulate skills.

Furthermore, high levels of inequality generate political and socioeconomic instability, which reduces the investment and social cohesion required to adjust to shocks and sustain economic development. The institutional, legal and social consequences of persistent inequality, thus, impair economic prospects.

The Survey for 2022 will highlight the roles that fiscal, monetary and structural policies can play in the quest for building an inclusive stakeholder economy.
Developing countries in Asia-Pacific recovered strongly in 2021 but recovery remains nascent.

The K-shaped recovery has been uneven both between and within countries.

Inflation edged up in 2021 across the region. The surge in inflation will adversely affect inequality as it further diminishes income of poorer households.
**Sustaining a nascent recovery**

### Strong growth rebound

After a significant contraction in 2020, economic activities in the developing countries in the Asia-Pacific region rebounded in 2021, thanks to robust external demand.

The growth momentum was dented somewhat towards the latter half of 2021 as countries grappled with renewed lockdowns and restrictions due to the wake of the Delta variant.

Moreover, risks to an inclusive recovery remain, as a K-shaped recovery has unfolded and is likely to leave long-lasting scars and set back progress made in implementing the 2030 Agenda and achieving the Sustainable Development Goals.

### Uneven Recovery

In the developing countries in the Asia-Pacific region, recovery has been uneven between and within countries. Between countries, different recovery trajectories, unequal vaccine access and differences in stimulus measures are observed.

Within countries, vast differences in recovery among sectors and opportunity gaps among sections of society are contributing to increased poverty and inequalities.

Across different sectors, the manufacturing sector has indeed benefited from the rising global demand for goods from the region and has seen sustained growth since mid-2020. However, mobility restrictions and border closures have had a more severe impact on the transportation and hospitality sectors.

Overall, economic growth in developing countries in Asia and the Pacific, estimated at 7.1 per cent in 2021, is projected to moderate to 4.5 per cent in 2022 and 5 per cent in 2023. Inflation has risen across the region, driven by rising food and fuel prices, affecting the poor disproportionately.
Since the onset of the pandemic, some 829 million informal workers have been the first to suffer adverse impacts due to job insecurity, low skills and lack of social safety nets. Formal employment seems to have partially recovered in 2021, as losses in working hours declined.

The divergence in employment recovery is also seen in more rapid turnaround in some sectors, such as information and communications technology, wholesale and retail segment and manufacturing. Contact-intensive sectors, such as accommodation and food services, have not seen a substantial increase.

**Rising inflation**

Against the backdrop of this strong yet nascent and uneven economic recovery and pandemic-induced supply disruptions, inflation edged up in 2021 across the region.

Core inflation, which excludes the more volatile food and fuel prices, also showed moderate increases in 2021, indicating that inflation may be becoming a more broad based phenomenon. Pandemic related expansionary fiscal and monetary responses have also affected inflation. The surge in inflation will adversely affect inequality as it further diminishes income of poorer households.

Looking ahead, the region should seek a balanced approach to co-exist with the pandemic – one which aims to protect public health but also allows livelihoods to continue to ensure economic and social well-being of people. For a sustained recovery, labour market policies, along with continuity in fiscal and monetary support are needed. However, in the midst of constrained fiscal space, increasing debt levels and rising inflationary pressures, providing continued support would be challenging.

External risks including global monetary tightening pressures and the possible spillovers through China’s property sector downturn will require vigilance and prudent policies to prevent large capital outflows as well as those to avert any economic and social fallout. Policies that aim to enhance productive capacities and productivity can minimize inequality and long-term scarring, thus contributing to sustained and inclusive economic recovery and development.
Countries with sufficient fiscal space can continue to spend for an inclusive recovery. However, those that do not have the means will have to work on both improving the efficiency of spending and collection of more revenues. Fiscal policies need to maintain spending in three major areas: health care, education and social protection.
The COVID-19 pandemic and the consequent economic crisis pose a fiscal dilemma:
• the need to spend remains elevated,
• while the means to spend are reduced.

To ensure recovery at all income levels and a more equal and resilient future, fiscal policies need to maintain spending in:

Health care

Education

Social Protection

Spend Smart

Governments should “spend smart” by reducing or eliminating inefficiencies in expenditures and spending on the most impactful sectors:

• Health care - must become UNIVERSAL
• Education - ALL children must receive high-quality education, especially girls and those in rural areas
• Social protection – must shield ALL throughout their life

Tax Fair

However, “smart spending” will not be enough to address all the fiscal needs. Support must come from the fiscal revenue side by “taxing fair”:

• Ensure all pay their share - meaning that tax avoidance and evasion is reduced
• Tax collection efficiency is increased - where digital technologies bring support
• Tax base is broadened – expansion through formalization of economic activities.

Investing in people through health care, education and social protection will not only minimize the negative long-term effects of the pandemic but will also help generate long-lasting returns.
Impact of seemingly same fiscal policy categories varies greatly across countries raising question on effectiveness and targeting

Impact* of fiscal policies on inequality according to 1 per cent of GDP expenditure/revenue.

For example, the impact of 1 per cent of GDP expenditure on education ranges from almost zero to a one-point reduction in the Gini coefficient.

The differences may be linked to who benefits relatively more from such expenditures; for instance, the relatively higher-income urban or lower-income rural populations.

Calls for significant systemic changes have been raised multiple times, and they have been delayed not only by lack of resources, but also by lack of commitment, as well as administrative and operational barriers. Since the pandemic has encouraged and facilitated innovation across all socio-economic dimensions, the global transition towards digitalization should be of particular interest to policymakers in the coming years. For example:

- **Fiscal management** - deployment of digital tools enhances expenditure control and brings much needed savings and efficiency gains.
- **Formalization of economic activities** - new technologies facilitate the accessibility of government services such as social protection but also enable revenue collection, ensuring that all contribute their fair share and receive support.
- **Health care** - digitalization does not only facilitate access to healthcare services, but also allows for better monitoring and allocation of resources.
- **Education** - as the world digitalizes, closing of digital divide becomes fundamental for equal access to education
- **Social protection** - digital technologies can deliver social protection transfers almost immediately at low cost and with high transparency.

*The graph presents an estimate of the total inequality change with a certain policy, compared to an alternative scenario where the policy would not exist.

Source: ESCAP estimates based on CEQ data.
Asia-Pacific central banks can and should play an important, complementary role in promoting inclusive development.

There are traditional ways how central banks contribute to inclusive development and societal welfare, but new areas of inclusive central banking are also emerging.
Central banking for a fairer future

The perceived failure of ‘developmental’ approach for central banks, which was pursued until the 1980s and benefited only a few economic sectors, led central banks in developing countries to narrowly focus on achieving inflation stability. The Survey 2022 argues that Asia-Pacific central banks should step up their engagement with inclusive development amid mounting fiscal constraints to tackling pandemic-induced rises in inequality. Currently only half of central banks in the region have taken up inclusive finance concerns, which is a missed opportunity given that financial access, financial education, and consumer protection benefit the poor relatively more than the better-off.

Even when central banks have no clear mandate for inclusive finance or development agenda, they should be concerned about high inequality because this undermines the effectiveness of monetary policy.

While monetary policy has indirectly helped the poor by striving to keep inflation low and stable, central banks can also consider the impact of monetary policy on income and wealth distribution, even raising ambitions to make economic equality a secondary goal and allocating part of asset purchases to domestic social bonds. As inflation targets are likely to be met in several Asia-Pacific economies in the coming few years, the pursuit of inequality-mindful monetary policy is possible.

The good news is that central banks in the region can support inclusive development through various policy strategies and tools: official reserve management, currency issuance and financial sector regulation can promote more inclusive societies.
The bulk of the estimated $9.1 trillion Asia-Pacific official reserves are invested in bank deposits and money market instruments with no clear or direct social benefits. Changes in investment strategies and internal governance on investment decisions can mobilize more official reserves for social purposes. More ambitious central banks can deploy part of excess reserves as seed capital for local social projects. As official reserves are deemed more than adequate in several Asia-Pacific economies, there is room for more social-oriented reserve management.

Half of all central banks in the region are exploring how a central bank digital currency can foster financial inclusion. With certain design attributes, this digital currency can help reduce the reliance on limited banking services and coverage of national personal identification system. However, central banks need to be clear about the objective of issuing a digital currency and carefully consider operational issues, such as legal frameworks and risk mitigation. A central bank digital currency also needs a supporting internet infrastructure and digital literacy.

To mobilize more financial resources for social purposes, Asia-Pacific countries can also issue social impact bonds and sustainability-linked bonds. Among others, these instruments enhance the effectiveness of development spending and attract more diverse bond issuers. To move beyond the current infancy stage, central banks and other financial supervisory authorities can conduct knowledge campaigns, create and harmonize social investment taxonomies, and provide financial assistance to partially cover high project transaction costs.
Managing structural changes for a fairer future

While redistributive policies play a role in inclusive development, evidence shows that pre-distributive policies – meaning those that take place before taxes and transfers – are even more important.

Policies should proactively promote labor-friendly technological changes and ‘engineer’ the market for more inclusive sharing of economic rewards.
Managing structural changes for a fairer future

While redistributive policies play a role in inclusive development, evidence shows that pre-distributive policies are even more important. Structural transformation provides a unique lens for analyzing pre-distribution dynamics over time.

The Asia-Pacific development experience to date suggests that pre-distribution dynamics driven by structural transformation can be diverse, but inclusive economic development paths are possible.

Past lessons show that the Kuznets tension – the tendency of increasing inequality at an early stage of structural transformation – can be eased with faster job creation through manufacturing development, more inclusive access to public goods and services, and greater equity at the start of economic takeoffs.

On the other hand, pre-existing inequalities, economic tertiarization, and structural bottlenecks may lead to greater inequality pressures even in the presence of economic growth.

The rise in inequality in Asia-Pacific countries was primarily driven by changes in pre-distribution. Economic structural transformation, in particular, has extensive linkages with pre-distribution inequality dynamics. The strategy for inclusive development should devote more attention to pre-distribution policies.

Prevention or Cure

The distribution of disposable income can be decomposed into two distinctive components:

**Predistribution** implies direct interventions to reduce income inequality

**Redistribution** means redistribution of incomes after taxes have been levied

Hence, predistribution can be viewed as preventing inequalities from arising in the first place, while redistribution is a cure once inequality has arisen.
New technological revolutions may lead to paradigm shifts in structural transformation possibilities and modalities, with mixed implications for inequality. The combined effect of automation and industrial reshoring may limit the space for labour-intensive manufacturing and modern services, resulting in risks of job polarization and higher inequality.

While greater offshoring potential of services, enabled by the digital and robotic transformation, may create new job opportunities for low-income labour in developing countries in services value chains. However, significant uncertainties in the direction, scale and speed of these transformations remain. It would thus be important for Asia-Pacific developing countries to adopt a balanced development strategy by embracing both manufacturing and modern services for poverty reduction and remain vigilant of and be prepared for the potential disruptions.

Meanwhile, structural transformation can be proactively guided, shaped and managed by governments for more inclusive outcomes and smooth transitions. Governments can explore a number of policy options, including public funding and incentives for the development and adoption of labour-enhancing rather than labour-replacing technologies, empowering labour in compensation negotiations and corporate decision making, ensuring fair competition and inclusive access to education and public services, and providing social protection floors and public support for reskilling and job-searching among others.
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BUILDING FORWARD FAIRER

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