The Asia-Pacific region faces extraordinary challenges due to economic and social disparities, made worse by the COVID-19 pandemic and rising vulnerabilities caused by climate change. Addressing these challenges will require a holistic and unified plan of action for combatting these economic and social disparities. The present paper serves to outline a comprehensive and integrated inclusive growth framework and apply it to the Asia-Pacific region. It also contains a discussion of policy options for achieving inclusive and sustainable growth.

Keywords: inclusive growth, growth, inequality, poverty, well-being, policy framework, sustainable development

JEL classification: I30, O40

1 The views expressed herein are those of the author and should not be attributed to the IMF, its Executive Board, or its management.
I. INTRODUCTION

Economic growth has powered improvements in average living standards. Since 1990 alone, extreme poverty declined by more than a billion people globally, mainly due to strong growth in China, India and other populous Asian countries. Likewise, economic growth is correlated with other outcomes. Globally, it has contributed to a dramatic rise in educational attainment and literacy, vast improvements in health, and a strong increase in the share of the world living in a democracy.

Yet, stark inequality across Asia and the Pacific and within countries of the region creates vast differences in living conditions and millions remain in poverty. Growth has been distributed unevenly, creating large income differences between countries. Gross domestic product (GDP) per capita on average from 2010 to 2019 ranges from more than $80,000 in Singapore and Macao, China, to less than $3,000 in several Pacific Island and Central Asian countries, expressed in comparable international prices.

Within country inequality has an increasing impact on economic well-being. National growth is not enough to ensure the improvement of individual welfare. Within-country inequality has risen in many advanced economies and several large emerging market economics (notably China, India, Indonesia and the Russian Federation) between the 1990s and 2010s.

The COVID-19 pandemic exposed and amplified existing inequalities. It impacted low-income people more than those at the upper end of the distribution, as they were more vulnerable to losing their jobs and had less access to high quality medical care. In addition, because their jobs required more person-to-person contact, low-income people were more at risk of exposure to the virus. The COVID-19 pandemic was expected to push an additional 89 million people in Asia and the Pacific into extreme poverty (ESCAP, 2021).

The pandemic also threatens economic and social scarring. Lower-income countries and vulnerable populations risk falling further behind (Cerra, Fatas and Saxena, 2021). The pandemic has intensified pre-existing gaps in the labour market and in education. Employment losses have been larger for women, youth and low-skilled workers (Alon and others, 2020). Likewise, developing countries have had longer school closures during the pandemic compared with advanced countries and they typically have substantial digital divides (Agarwal, 2022; ESCAP, 2021). Previous epidemics led to a rise in inequality and a decline in the medium term in per capita income, investment and consumption in Asia and the Pacific (ESCAP, 2021).

Looking to the future, technological advances, globalization and climate change pose additional challenges and risks for improving inclusive growth. The impact of
technological progress and automation on employment and wages is more uncertain than ever. Continued technological advancements in communications combined with differences in opportunities across countries are likely to maintain incentives for further globalization, including in financial flows, trade and migration. Over the coming decades, climate change is expected to cause large weather shocks, alter agriculture and increase pressures that drive migration. Climate-linked disasters in the Asia and Pacific region could significantly increase its Gini coefficient and under-5 mortality rate, reduce education rates (ESCAP, 2019) and cause losses of about 2.5 per cent of GDP (ESCAP, 2020).

The remainder of the present paper provides policy perspectives for addressing these challenges and improving inclusive growth. Section II serves to outline the design of an overarching inclusive growth policy framework, considers the trade-offs between growth and inclusion, and discusses how to integrate the policy framework into decision-making processes. Section III elaborates on each component of the inclusive growth framework, summarizing the key issues and policy options for Asia and the Pacific. Section IV concludes the paper.

II. DESIGNING AN INCLUSIVE GROWTH FRAMEWORK

2.1 The inclusive growth framework

Economic well-being, social inclusion and environmental sustainability are interdependent and fundamental to sustainable and inclusive development. In 2015, United Nations member States adopted the 17 Sustainable Development Goals as a call to action to end poverty and hunger and reduce a wide range of deprivations and disparities while spurring economic growth and safeguarding the natural environment. Given that inclusive, green and sustainable growth is multidimensional, a whole of society approach will be required for progress.

In this paper, inclusive growth refers to strong economic growth that is inclusive and sustainable. Economic growth refers to increases in the production of goods and services that are valued by people, providing the means for a better standard of living. Growth is often measured as changes in GDP for practical purposes, but economic welfare can include alternative measures that address the shortcomings of GDP (IMF, 2020). Inclusion refers to broadly sharing the improvements in living standards among all groups in society, providing access to basic services, ensuring participation in economic life and empowerment in social and political life through strong governance and public sector accountability. Sustainability means that the current path of consumption and social welfare can be sustained into the future to the benefit of both current and future generations. This requires avoiding boom-bust policies and maintaining environmental sustainability.
An inclusive growth framework provides a systematic way to analyse the economic interlinkages and to design the appropriate policy responses for inclusive and sustainable development. It can describe the elements and outline how they are connected (figure 1). The framework draws on the standard economic paradigm of a production function that combines inputs from both the private sector and the Government to generate economic activity and to determine its distribution.

**Figure 1. Inclusive growth framework**

A large share of growth and inequality is determined by private sector activities and by policies that affect the private sector. Private sector firms produce goods and services and individuals earn income on their inputs of labour, capital and technological innovation. These inputs can be derived from domestic sources or through globalization, which contributes to the supply of labour, capital and technology through migration, capital flows and technology transfers across borders. In addition, the private sector responds to price signals and incentives to ensure that goods and services are produced and sold in markets. Inclusive growth requires fair and competitive marketplaces with level playing fields – domestically and through international trade – to ensure appropriate prices and opportunities for all to contribute and to reap the output of production. At the stage of production, Governments shape the functioning of the market and the incentives that firms and individuals face in their employment, investment and innovation decisions.
The Government contributes inputs and establishes the right conditions for growth and for inclusion. Government initiatives for developing and distributing vaccines and health services more generally have been critical during the pandemic. The Government delivers an array of public services, including public education and infrastructure. In some sectors, especially those characterized as natural monopolies, the Government engages directly in production. Government policies and provision of public services that increase access to health, education and finance affect the “pre-distribution” phase, impacting the stocks of human and physical capital that feed into the production process. The Government uses macroeconomic tools such as fiscal and monetary stabilization to smooth economic fluctuations and avoid disruptive recessions and crises. Beyond that, the institutions of the State need to provide legal protections and a governance framework to establish the “rules of the game”. The political system establishes opportunities for citizens to voice their views on social goals and advocate for inclusive and sustainable reforms and hold political leaders accountable for making decisions in the best interest of the country. After production and the distribution of market income, the Government uses tax and spending instruments to redistribute income to increase the welfare of the very poorest and reduce income disparities according to the weights that the society places on equality. Usually, the market or pre-fiscal outcomes tend to be more unequally distributed than outcomes after government redistribution through taxes and transfers.

The sharing of economic benefits can be analysed beyond just an aggregate measure of inequality. Inclusivity can be considered along a variety of dimensions, such as gender, age and other personal attributes, as well as across regions in a country. Comparing the outcomes of the young and the old is important, as in some countries these groups tend to be more vulnerable to poverty. Furthermore, there is an intertemporal aspect of inclusion: economic benefits, including from resource wealth, need to be shared across current and future generations. Therefore, inclusive growth must be sustainable, and sustainability requires addressing the potential detrimental impact of climate change on future generations.

Finally, there is a feedback loop from the distribution of outcomes to private and public sector inputs. The distribution of outcomes affects future production through labour supply, savings and entrepreneurship, including through the impact on the next generation. Outcomes feed into future government inputs and policies through the political system.

Ultimately, each element of the framework is linked to the rest. The framework illustrates each component and its main function and channels of interaction. But inclusive growth is macroeconomic in nature, and thus all components of the framework are fully interdependent. The framework is also dynamic. Outcomes create endowments
of wealth and capital that affect subsequent inputs to production. Outcomes and factor payments create differential opportunities and rewards that translate into political action for policy reform. Changes in governance or in policies affect outcomes, but they also affect incentives in private production. Thus, in establishing an agenda for reform, it is important to start from a holistic view of the framework.

2.2 Trade-offs between growth and inclusion

One obvious policy question is whether a society needs to sacrifice growth to achieve more inclusion. Or more generally, is there a trade-off between growth and inclusion? There are complex linkages between growth and inclusion, with causation going in both directions and several channels mediating the relationship (Cerra, Lama and Loayza, 2021). On the one hand, higher growth can create more job opportunities as well as providing resources for redistribution, lowering poverty and inequality. On the other hand, depending on the source of growth, some sectors may grow faster than others, or the returns to capital and skilled labour might be higher than the returns to unskilled labour, leading to higher inequality. Empirical evidence shows that economic growth leads robustly to poverty reduction but has an ambiguous impact on inequality. In the opposite direction of causation, policies that result in moderate inequality based on rewards for saving, investing, studying, innovating and taking risks can generate higher growth. Conversely, inequality that is too high may produce poverty traps, crime and social conflict, which could impair growth.

Must societies tolerate inequality to spur growth? The evidence suggests that it is important to distinguish between equality of outcomes and equality of opportunities. Policies that provide incentives for saving, investing and innovating may lead to higher growth and result in moderate inequality. However, expanding access to opportunities – such as through access to health care, education, social protection and finance – can raise growth and improve equality at the same time.

2.3 Integrating inclusive growth into policymaking

Adopting an inclusive growth framework into the policy cycle involves several steps, as outlined below.

Diagnosis: The first step is to diagnose the facts of growth, inclusion and sustainability. This can include measures of poverty and inequality and gaps in a

---

2 Analysing the dynamics of the extreme poverty rate (at the poverty line of $1.90 per day in purchasing power parity) in 135 countries from 1974 to 2018, Bergstrom (2020) finds that 90 per cent of the variation of poverty rates can be explained by changes in GDP per capita. Even so, the poverty reduction elasticity of growth (percentage decline in poverty due to percentage increase in growth) depends on inequality. Growth that is more inclusive (inequality reducing) has a greater impact on poverty reduction than growth accompanied by rising inequality.
variety of outcomes and opportunities, as well as comparing the country’s performance to peers and international benchmarks using indicators of several international organizations.

Prioritization: Few countries are likely to do well on all aspects of inclusive growth. Policymakers need to prioritize the goals and targets of their inclusive growth strategy. In developing the overarching objectives and strategy of the reform, it is critical to consider the main concerns of the society and the interests of stakeholders and their capacity to support or block reform.

Policy analysis and implementation: Specific policies must be devised and implemented by ministries and agencies responsible for each policy area. This would be underpinned by analysis of the expected impact, the political and practical feasibility, and the country’s specific circumstances. Insights can be gained from economic literature and comparable country experiences, but inevitably some judgment of the country’s specific circumstances will be required in designing the right policy mix.

Monitoring and evaluation: As the strategy is implemented, results must be monitored and evaluated. This information would feed back into adjustments to the strategy as experience develops.

III. AN INCLUSIVE GROWTH FRAMEWORK FOR ASIA AND THE PACIFIC

3.1 Labour, capital and technology

The inclusive growth framework described above can be applied to assess policy options for Asia and the Pacific. Trends in poverty and inequality often depend more on changes in the market or pre-tax distribution than on changes in redistribution. Production of output and services provides income for those providing labour, capital (or finance) and technology. The Government nonetheless has a role in shaping outcomes in the private sector through public policies and regulation.

Labour income represents the largest share of the economic pie and, for most people, constitutes most if not all of their income. An inclusive labour market provides opportunities to people of working age to participate in high quality, paid employment to meet basic needs (El-Ganainy and others, 2021). It rewards workers based on producing outputs, rather than personal attributes unrelated to their productivity. An inclusive labour market provides mechanisms to insure against shocks and protect against exploitation. It is flexible in providing working arrangements for workers with family care responsibilities and avoids barriers to access. A labour market that is supportive of inclusive growth reallocates workers quickly and effectively between...
jobs as the economy adjusts to macroeconomic shocks and provide incentives and opportunities for improving skills to adjust to technological change. In developing and emerging market economies, informal work and domestic work constitute a high share of total employment. For instance, informality accounts for at least half of the labour force in Asian regions, and nearly 90 per cent in South Asia (figure 2). Informal jobs usually lack the benefits and protections of formal work. Even in the formal sector, there are different employment arrangements, with workers receiving only part-time or temporary contracts.

**Figure 2. Share of informal employment, 2019**

Inclusive labour markets can be supported through private and public initiatives. Private firms, employers’ associations, and labour unions play a role in promoting an inclusive labour market and workplace. Even without legal requirements or regulation, private entities can create mutually beneficial agreements and solutions on benefits, working conditions, family leave and programmes for enhancing skills. The Government can use tax, legal and regulatory powers to set standards and provide supporting programmes. Important labour market policies include unemployment insurance, minimum wage, employment protection legislation and active labour market policies.

The conversion of savings into investment adds to capital and spurs economic
growth. Financial development and inclusion ensure people have access to savings vehicles and can borrow to invest in physical and human capital. A well-functioning financial system helps to mobilize and pool savings and allocates savings into productive investment projects, monitors investments, diversifies risk and facilitates the exchange of information and goods and services (Levine, 2005).

Financial inclusion has many benefits for households and firms. Financial institutions can provide funding for education and allow talented but financially constrained individuals to become entrepreneurs. It allows existing firms to scale up operations to efficient levels. Using financial institutions for savings can reduce theft and reinforce women’s economic empowerment. Insurance products can help households to manage financial risks. Financial inclusion is considerably higher in advanced economies than in emerging market economies and developing countries, with five countries in Asia accounting for approximately 40 per cent of the global unbanked population (figure 3).

**Figure 3. Adults without a bank account, percentage of global total, 2017**

![Pie chart showing the distribution of adults without a bank account by country, with the largest shares going to China (13%), India (11%), and the rest of the world (61%)](image)

*Source: Global Findex database.*

Financial inclusion can be promoted by addressing informational asymmetries and other frictions. This includes facilitating access to financial services such as credit bureaus and collateral registries and enhancing financial literacy, and through technologies such as peer-to-peer lending, mobile banking and microcredit (Barajas and others, 2020). But increasing the use of formal finance, particularly access to
credit, needs to be balanced with maintaining financial stability through appropriate laws and regulation.

Technological progress is the principal force behind rising global prosperity, but it risks major disruption. Technological advancement over the past few decades has reflected rapid progress in information and communications systems, among other factors. It has been a key driver of global prosperity, which has helped many people to rise out of poverty. However, technology has been more complementary to high-skilled labour, leading to a wage premium for skilled over unskilled labour and contributing to inequality. Average wages in many countries, including Indonesia, Japan and the Republic of Korea, have fallen far short of the technology-driven rise in productivity (figure 4). Contributing factors include a relative decline in investment goods prices (IMF, 2017), the impact of automation (Acemoglu and Restrepo, 2018), and increases in monopoly and monopsony power (Eeckhout, 2021). Looking ahead, there is fear that technology, including artificial intelligence, will be a disruptive force and could take away even more human jobs (Korinek, Schindler and Stiglitz, 2021). Technological progress has the potential to deprive many developing countries of their key comparative advantage (cheap labour) while excluding them from participating in some of the gains provided by new technologies and leading to premature deindustrialization.

Figure 4. Productivity and earnings growth in selected countries

Source: Organisation for Economic Co-Operation and Development (OECD), Bureau of Labour Statistics for Japan and the Republic of Korea; Tadjoeddin and Chowdhury (2018) for Indonesia; and authors’ calculations.

Notes: Data for Japan and the Republic of Korea are measured using purchasing power parities for private consumption, so the series may differ from national sources.

Factors of production do not operate in isolation; they are organized into firms that compete in markets for goods and services. Since 2000, there has been a rise
in market concentration and corporate market power (Aghion, Cherif and Hasanov, 2021). Moreover, while some types of technology may be non-rival in use (thus, in theory they can facilitate broad-based growth), in practice technology is generated by innovation activity that is excludable and may permit supernormal returns for some time. Innovation and competition are two key aspects of the market structure that impact inclusive growth.

3.2 Globalization

Global integration related to trade and cross-border capital and labour flows is likely to continue. A large part of the income of any individual is determined by her/his country of residence, and disparities across countries are wide. There is a strong incentive for people in lower income countries to benefit from the global economy by migrating to higher income countries which may offer higher returns on investments, and lower income countries can tap into global savings through financial market integration. In addition, countries tend to specialize in different products and services, and opening the economy to international trade can enable countries to benefit from lower cost imports and to find additional foreign markets for domestic goods. International trade, capital flows (including foreign direct investment), and migration are the open economy counterparts to the labour market, capital/finance, technology and markets/business environment.

The preponderance of empirical evidence suggests that trade is beneficial to inclusive growth. As in other regions, countries in Asia and the Pacific that increased trade as a share of GDP between 1950 to 2014 experienced a sharply higher rate of economic growth (figure 5). Studies using a variety of research methodologies find that trade openness has a positive relationship with growth, productivity and innovation, and leads to lower poverty and reduced prices (Bacchetta and others, 2021). Economic theory predicts that trade openness raises the demand for a country’s abundant factor and its associated factor returns (Stolper and Samuelson, 1941); therefore, the theory predicts a decline in inequality in developing countries due to rising wages of unskilled labour (where unskilled labour is the abundant factor). Simulation studies find mixed results of trade: Artuc, Porto and Rijkers (2020) find that the richest quintile of households gains more than the poorest from tariff reductions in 37 of 54 developing countries (while the poorest quintile gains more than the richest in 17 countries), but Fajgelbaum and Khandelwal (2016) find that trade typically favours the poor. Panel regressions using actual historical data show that trade openness was associated with lower inequality in emerging and developing countries and has no significant aggregate relationship with the Gini coefficient in advanced countries (Beaton, Cebotari and Komaromi, 2017; Jaumotte, Lall and Papageorgiou, 2013). Event studies of liberalization episodes, mainly reflecting emerging market countries, corroborates the beneficial impact of trade. In addition
to boosting growth, investment and foreign direct investment, trade liberalization prevented the steep rise in inequality experienced by countries that remained relatively closed to international trade (Beaton, Cebotari and Komaromi, 2017). Cerdeiro and Komaromi (2020) exploit the exogenous geographic characteristics of countries to estimate the causal effect of trade on inequality; they find the positive impact of trade on income is highest for the poorest income deciles, and trade openness that is one percentage point higher is associated with 0.2–0.6 points lower net Gini coefficient. In addition, open economies have lower rates of informality and higher levels of gender equality, including smaller gender wage gaps (Black and Brainerd, 2004; Klein, Moser and Urban, 2010). Firms that engage in international trade employ substantially more women than non-exporting firms (World Bank and World Trade Organization, 2020). Bacchetta and others (2021) provide a survey of the empirical findings between trade and inclusive growth.

Figure 5. Trade and growth in Asia and the Pacific, 1950–2014

Source: World Bank and author’s calculations.
Notes: CHN, China; GDP, gross domestic product; IDN, Indonesia; IND, India; IRN, Iran (Islamic Republic of); JPN, Japan; KOR, Republic of Korea; LKA, Sri Lanka; MYS, Malaysia; NZL, New Zealand; PAK, Pakistan; PHL, Philippines; THA, Thailand.
While theory and evidence point to gains from trade at the aggregate level, policy intervention is needed to help those who lose out. The economic impact of trade depends on country circumstances and the specifics of the trade policies, implying that trade, like any other force of structural transformation, can have an adverse impact on some individuals or communities (UNCTAD, 2019). Trade policies can be designed to minimize adverse distributional effects, such as gradually phasing in trade liberalization, contributing to export promotion and trade facilitation, including helping firms to meet health and regulatory standards required by destination countries. Governments can use complementary policies, including social assistance programmes, providing information, job search support, education and retraining. They can promote firm entry and job creation by maintaining a strong business environment and ensuring an inclusive labour market.

Financial integration allows developing countries to tap foreign savings for domestic investment, thereby speeding up the rate of capital accumulation and growth. However, there are pitfalls. While the evidence confirms that financial integration has a positive relationship with growth, it tends to be associated with higher inequality (Eichengreen and others, 2021). Short-term capital flows may contribute to macroeconomic volatility and crises. Foreign direct investment inflows raise gross capital formation, but associated technology transfers may advantage skilled labour over unskilled labour, leading to higher wage inequality.

A broad policy package is needed to limit the risks associated with financial integration. These include macroeconomic adjustment and stabilization, and micro- and macroprudential policies to improve the resilience of the financial sector, capital flow management policies to influence the level and composition of flows, and redistributive policies and social safety nets to mitigate adverse effects.

3.3 Government

Governments can foster inclusive growth in a variety of ways. Governments establish the institutions and governing conditions of the economy, use policy instruments to promote economic stability and directly impact the distribution of income through tax policies and spending and transfers, especially in key public services such as health and education. Understanding the appropriate tools for improving inclusive growth is not enough. Public policies must be implemented within a given national or local system of unequal political power.

The quality of a State’s governance shapes its effectiveness in spurring inclusive development. Governance includes the institutional frameworks and practices of the public sector, mechanisms and quality of oversight of key institutions such as the central bank, oversight of the financial system, regulation of the private sector to address market failures and the rule of law, including protection of property rights
(Ivanyna and Salerno, 2021). Avoiding corruption is an important component of governance. Corruption can have a sizeable macroeconomic impact. Some studies find for example that bribes account for as much as 2 per cent of global GDP. A significant share of firms, as much as 9 per cent in South Asia, report corruption as a top concern about the business environment (figure 6). Corruption and poor governance can breed lack of trust in the Government and undermine support for reform. This is especially critical when the Government wants to introduce a reform that has potentially large benefits over a long horizon, but entails some short-term costs. If citizens are suspicious of public officials, they may not tolerate reforms with short-term costs because they will not trust that the reforms will deliver long-term benefits.

**Figure 6. Percentage of firms choosing corruption as top business environment obstacle**

![Bar chart showing percentage of firms choosing corruption as top business environment obstacle across different regions](image)


Strengthening governance involves enhancing the capacity and efficiency of public sector operations. It entails reducing the opportunities for corruption, increasing its cost and likelihood of detection, such as through a regulatory framework with fewer discretionary decisions and greater transparency in government processes. Cross-border agreements are important for combatting corruption and tax evasion. For example, anti-money laundering measures and agreements to share financial data with home country tax authorities can combat illicit activity while tax agreements between countries can reduce legal tax avoidance.

The political economy defines the relationship between the State and its citizens. It determines the amount of redistribution through the tax and transfer system
A framework for inclusive and sustainable growth in Asia and the Pacific

and shapes the pre-distribution economic structure through policies on access to education, health and finance. The relationship between the political system and inclusive growth is complex and much depends on history, laws and customs, social trust and ethnic cleavages, among other factors. Support for redistribution is typically higher in democracies and during periods of economic insecurity and among sociodemographic groups that have been disadvantaged (Dutzler, Johnson and Muthoora, 2021). Evidence suggests that inclusive political institutions are correlated with inclusive economic institutions and broad-based growth.

Direct government intervention policies affect the distribution of income and prevalence of poverty. Fiscal policy is a powerful tool to reduce inequality through redistribution. In advanced economies, direct taxes and transfers reduce income inequality by about one third on average. Given higher administrative capacity, advanced countries are able to implement more fiscal redistribution (and therefore reduce inequality more) than developing countries. Transfers have had a greater impact than taxes on reducing income inequality. In developing countries, fiscal policy reduces the poverty rate by 2.25 per cent on average with nearly all of the impact coming from transfers rather than taxes. Even so, the impact of fiscal policy on inclusive growth needs to jointly account for the revenue and expenditure side. For example, even if taxes alone result in little direct reduction in poverty and inequality, they provide resources for transfers and spending that can improve the lives of the poor. So, efforts to mobilize domestic revenue can be impactful for inclusive growth.

Taxation serves to raise revenue to finance government spending priorities, but it can also be a tool for redistribution. Tax policy design balances principles of efficiency, equity and practicality, and it is influenced by political economy considerations (Abdelkader and de Mooij, 2020). Digging deeper, some tax policies require a trade-off between reducing inequality and increasing growth. Progressive income taxes can reduce inequality, but high marginal tax rates could discourage work and investment. The value added tax is less damaging to growth but may be regressive given that it is a tax on consumption and the poor typically consume a higher share of their income. Tax policies that improve efficiency and equity at the same time include broadening the tax base, especially by eliminating loopholes and exemptions, simplifying the tax code and taking other measures to fight corruption and tax evasion, and taxing profits that arise from excess market power.

Government expenditure promotes inclusive growth through the provision of public services and infrastructure and typically achieves more redistribution than does taxation. Education and health are among the most critical components of public expenditure for eliminating poverty and improving inclusive growth. Countries need to spend effectively to provide access and quality in education and health care services. Empirical evidence shows social spending as a share of GDP has been
strongly associated with reductions in inequality (Zouhar and others, 2021). Other public spending to raise equitable growth includes public infrastructure to bolster private investment and improve productivity, measures to improve labour-force participation and budget support for research and development. Conversely, some types of universal subsidies are bad for both growth and equity. One important example is energy subsidies, which are large in some countries. Energy subsidies tend to disproportionately benefit the rich and promote the overuse of energy, which is detrimental to the environment.

Macroeconomic volatility and shocks have considerable impacts on growth, the distribution of income and wealth, and other dimensions of inclusive growth.\(^3\) For example, more individuals become unemployed during recessions and crises, or experience a cut in their wages or work hours. Indeed, countries that have high volatility of GDP per capita also have high volatility of unemployment and poverty (Davoodi, Montiel and Ter-Martirosyan, 2021). Inequality, poverty and other aspects of inclusive growth, in turn, can be sources of macroeconomic volatility and trigger or amplify shocks.

Economic crises and political instability generate scarring in both advanced and developing economies. A recession leads to a fall in economic activity below the economy’s previous trend, and usually the lost output is never fully recuperated (Cerra and Saxena, 2008). Economic volatility and scarring increase inequality within countries (Davoodi, Montiel and Ter-Martirosyan, 2021). In Asia and the Pacific, adverse economic and natural shocks have resulted in lower incomes, higher inequality and unemployment, slower accumulation of physical and human capital, and weaker environmental performance (ESCAP, 2021). Output scarring, or hysteresis, can be reduced by fiscal and monetary expansions during recessions and flexible exchange rate regimes (Cerra, Panizza and Saxena, 2013; ESCAP, 2021). Thus, countercyclical macroeconomic policies can not only reduce volatility but also improve inclusive growth.

The COVID-19 pandemic illustrates the importance of a strong macroeconomic policy response. For example, the United States of America and other advanced economies provided massive macroeconomic support to firms and households in terms of both the health response and income support. Recent forecasts from the International Monetary Fund show the GDPs of advanced economies bouncing back to their pre-pandemic trends. Many emerging and developing countries, however, have

\[^3\] Many studies define macroeconomic volatility as the standard deviation of real GDP and others as the frequency and/or depth of recessions and crises. Some other studies focus on the volatility of nominal GDP and inflation below a low threshold (i.e. 5 per cent) in order to explore the role of monetary policy (Romer and Romer, 1999).
not had the macroeconomic space to respond as vigorously and are consequently projected to have substantially lower levels of GDP in the next several years relative to pre-pandemic forecasts (figure 7). The pandemic and the policy response led to projected increases in public debt levels for all country groups. For example, in emerging and middle-income Asian economies, the pandemic led to an increase in projected gross government debt by between 5 and 10 per cent of GDP. This reduced the fiscal space for dealing with future challenges and increased the risk of public debt distress.

Figure 7. Effect of the pandemic on gross domestic product and general government gross debt

Source: International Monetary Fund (IMF), World Economic Outlook database; and IMF staff estimates.
Notes: All quantities are converted into 2019 prices using the projected evolution of the GDP deflator. GDP, gross domestic product.

Output scarring also thwarts development. According to traditional growth theory, poor countries should catch up to the per capita income levels of rich countries because each dollar of investment should generate a higher return in poor countries that have little capital to start with. The historical evidence, however, does not support the theory of convergence. Output scarring provides an explanation (Cerra and Saxena, 2017). All countries experience negative shocks with persistent impacts, but recessions are larger and more frequent in poor countries than in rich countries, and they keep pushing poor countries back, preventing them from catching up.

3.4 Outcomes

Opportunities and outcomes are not equally distributed to all groups in society for a variety of economic, historical and cultural reasons. Disparities vary from country
to country, but opportunities and outcomes depend on gender, race, ethnicity, age, sexual orientation, religion, language and other attributes. There are often large disparities between regions within a country. Inequality across generations arises from natural resource depletion, climate change and other forms of environmental damage that have detrimental effects on future generations.

Despite progress in narrowing the gaps, gender disparities persist. Across a spectrum of labour market indicators, outcomes for women lag behind those for men (Fernandez and others, 2021). Notably, labour force participation of women remains significantly below that of men and wages and earnings are far from parity. These gender disadvantages translate into higher inequality and poverty for women. For example, median gender pay gaps average more than 10 per cent in advanced and emerging economies and are as high as 40 per cent in Pakistan (figure 8). In addition to the labour market outcomes, women face other obstacles, such as legal barriers to property ownership, low rates of political empowerment, higher rates of infanticide and domestic violence.

![Figure 8. Factor-weighted gender pay gaps using hourly wages, average of 2015–2019](image)

**Source:** International Labour Organization (ILO) and authors’ calculations.

**Note:** Country groupings are based on the International Monetary Fund (IMF) World Economic Outlook classification. Averages are calculated based on countries shown in each group.
Given the pervasive nature of gender disparities, a panoply of policies is required to break barriers and foster gender equity. This starts with changing laws that discriminate against women working and owning property, and encouraging women’s participating in economic life. Governments can enact and enforce laws to protect against violence and child marriage. The Government can use fiscal instruments to provide sufficient spending on education and health and to eliminate discriminatory and higher marginal taxes on second earners. Many countries are adopting gender budgeting, a practice in which fiscal measures are assessed based on the impact they have on gender inequality. An array of labour market policies, such as childcare support, parental leave and flexible working arrangements, can encourage women to enter the labour force.

The youth are often among the most vulnerable demographic groups. They have significantly worse labour market outcomes than other groups in many countries. Strategies to foster youth integration into the labour market need to be broad based (Badual, Isakova and Ter-Martirosyan, 2021). They would include ensuring good quality education from the primary level all the way up to tertiary education, vocational training and apprenticeships. They would also include policies to foster flexible labour markets with social safety nets to protect workers and active labour market policies to support employment along with measures to foster private sector development and entrepreneurship.

In some countries, the poverty rates for people over 65 years of age are much higher than for the overall population. Older people often rely on income and health care support from public systems that are under increasing strain due to demographic and other trends. In countries with comprehensive and mature systems of social protection and ageing populations, policies should maintain a good balance between financial sustainability and pension adequacy. In many developing countries with large informal sectors, the policy objective is to broaden coverage and increase formalization, including through minimum social pensions. For example, only about half the population of pensionable age receives a pension in Asia and the Pacific, and only about a quarter in South Asia (figure 9).
Figure 9. Pension coverage for older persons

Source: ILO, World Social Protection database, based on Social Security Inquiry; ILOSTAT; OECD Social Benefit Recipients database; and national sources.

Note: Proportion of older persons receiving a pension: ratio of persons above statutory retirement age receiving an old-age pension to the persons above statutory retirement age. Regional and global estimates weighted by population of retirement age.

Different regions within countries face significant disparities in economic performance and living standards, contributing to overall inequality. Options for reducing regional disparities include policies focused on raising growth and business opportunities in lagging regions; integrating or better connecting leading and lagging
regions; and improving the ability of people in lagging regions to relocate to leading
regions (Floerkemeier, Spatafora and Venables, 2021). Some countries and regions
are highly dependent on income from natural resources, which often fuels conflict
and corruption (Pouokam, 2021). Strong political governance is especially important
to avoid fragility. In addition, Governments need to invest resource windfalls in
human capital and infrastructure and adopt appropriate fiscal frameworks to share
the benefits of resource wealth across generations.

3.5 Climate

Climate change is arguably the most significant threat to the sustainability of
growth and the well-being of future generations. Climate change brings about
substantial socioeconomic damages. These depend on country circumstances, but
they are generally larger for the poor, as they have fewer resources to adapt, are
more dependent on agriculture and tend to live in areas that are already exposed
to more adverse climate conditions (Bhattacharya and others, 2021). Some of the
most severe impacts are expected in South Asia.

Governments need to employ a broad policy package to enable the green
transition. Putting a price on carbon helps to address the externality of the use of
fossil fuel while raising needed revenue for development. This can be complemented
with offsetting any impact on the poor and affected workers, businesses and regions
through transfers and social spending. Carbon pricing can be reinforced with sector-
specific policies, including regulations, energy efficiency standards and feebates. It
is critical to eliminate fossil fuel subsidies, which degrade the environment, deprive
the Government of revenue and generally benefit the rich. Other policies include
aligning financial sector policies with climate objectives, providing incentives for
green investment and innovation, and promoting international cooperation, including
mobilizing financial resources for lower-income countries. Even with strong global
mitigation efforts, adaptation is necessary for many countries to cope with climate
change. The key policies are information and investment policies to reduce the
exposure to climate shocks and macroeconomic policies to smooth and facilitate the
structural transformation. Mitigation and adaptation policies such as land restoration
and sustainable agriculture can help poor subsistence farmers. Mitigation can provide
important co-benefits. For example, switching to cleaner sources of energy in transport
can help to reduce air pollution, which is a major source of health problems and
death, especially in developing countries. According to Parry, Mylonas and Vernon
(2017), annually increasing the tax per ton of coal by 150 rupees ($2.25) from 2017
to 2030 could avoid over 270,000 air pollution deaths, raise revenue of 1 per cent
of GDP in 2030, reduce carbon dioxide emissions by 12 per cent and generate net
economic benefits of approximately 1 per cent of GDP.
IV. CONCLUSION

Given the multidimensional linkages, a comprehensive policy approach should be employed to improve inclusive growth. The challenge is to engineer higher growth and inclusion in tandem. An equitable distribution of income from market activities depends on the Government to ensure a fair and competitive market for goods, deepen financial inclusion and promote inclusive labour markets, both domestically and as the country integrates its economy with the rest of the world. The Government also has a role in providing complementary infrastructure and education and health services, as well as creating strong institutions and maintaining macroeconomic stability. In addition, the Government can use tax and spending tools and other policy instruments to provide social protection for the poor and vulnerable, redistribute income and address economic and social disparities, in accordance with the society’s preferences. Finally, policies need to focus not only on the immediate situation, but also on ensuring economic and environmental sustainability over time to safeguard the well-being of current and future generations.

ACKNOWLEDGEMENTS

The views expressed herein are those of the author and should not be attributed to the IMF, its Executive Board, or its management.

NOTE ON CONTRIBUTORS

Valerie Cerra is an Assistant Director in the Fiscal Affairs Department of the IMF and has previously been involved in policy advice, lending and capacity development in several other IMF departments. She has published in leading economics journals on economic scarring, inclusive growth and international macroeconomics.
REFERENCES


Agarwal, Ruchir (2022). Pandemic Scars may be Twice as Deep for Students in Developing Countries. IMF Blog, 2 February 2022.


Alon, Titan, and others (2020). This Time It’s Different: The Role of Women’s Employment in a Pandemic Recession. CEPR Discussion Paper, No. 15149.


_________ (2020). Economic and Social Survey of Asia and the Pacific.

_________ (2021). Economic and Social Survey of Asia and the Pacific.

