



# **ECONOMIC AND SOCIAL SURVEY OF ASIA AND THE PACIFIC 2021**

**Towards post-COVID-19 resilient economies**





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United Nations publication  
Sales No. E.21.II.F.5  
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Printed in Bangkok  
ISBN: 978-92-1-120823-8  
e-ISBN: 978-92-1-604057-4  
ISSN: 0252-5704  
eISSN: 2412-0979  
ST/ESCAP/2942

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# FOREWORD



The COVID-19 pandemic has caused severe social and economic damage across the world, setting back development gains by years. Job losses, a sharp reversal of progress in poverty reduction, school closures and heightened inequalities will leave long-term scars.

This year's *Economic and Social Survey of Asia and the Pacific* finds that over the course of 2020, the developing Asia-Pacific region experienced a 1.0 per cent contraction in gross domestic product, and lost the equivalent of 140 million full-time jobs, pushing a further 89 million people back into extreme poverty. In dealing with these and other devastating impacts, policymakers have had to make tough decisions between saving lives and saving livelihoods. As we navigate our way out of this shock, the policy choices we make now should be green, just and sustainable in order to build long-term resilience and reduce the severity of future shocks.

This calls for a transformation in macroeconomic policy thinking so that it is not defined by a narrow and short-sighted focus on economic growth alone. Towards that end, the *Survey* recommends a package of reforms and investments in social services, digital access, gender equality and green development aimed at tackling pre-crisis vulnerabilities and building a more inclusive and sustainable future. This will require greater upfront spending on social and environmental protection. The *Survey* therefore calls for increased international assistance to reduce the vulnerability and debt burden of developing countries, and offers options to meet immediate and medium-term financing needs.

I commend the findings and policy recommendations of the *Survey* to all stakeholders and development partners in the region as Asia-Pacific countries seize the opportunity created by this crisis to reignite the *Decade of Action* to accelerate implementation of the 2030 Agenda for Sustainable Development.

A handwritten signature in black ink, which appears to read 'António Guterres'.

**António Guterres**  
Secretary-General of  
the United Nations

# PREFACE



The COVID-19 pandemic has posed unprecedented challenges for policymaking in Asia and the Pacific, setting back development gains by years, if not decades, and revealing the lack of preparedness of many countries for dealing with such shocks. Nonetheless, Asian and Pacific countries initiated substantial policy responses to cope with the severe social and economic effects of the crisis, although the ability to sustain such needed support would be a challenge for several countries. The Secretary-General also launched several initiatives to save lives, protect societies and help them recover better, and mobilized the entire United Nations system, including ESCAP, to assist Member States.

One of the key lessons emerging from the crisis is that protecting development from shocks and building resilience should be a pressing priority for the region's policymakers. Slow progress towards achieving the Sustainable Development Goals had already exposed existing vulnerabilities to crises. The need to rebuild better towards a more resilient, inclusive and sustainable future was highlighted by leading policymakers and eminent persons during the 2020 ESCAP Regional Conversation Series.

The 2021 *Economic and Social Survey of Asia and the Pacific* provides our member States with timely analytical and policy perspectives on building resilient post-COVID-19 economies. The *Survey* maps out a “riskscape” of economic and non-economic shocks – financial crises, terms of trade shocks, natural disasters and epidemics – and finds that these leave behind long-lasting scars that reverse hard-won gains across all three dimensions of sustainable development. Highlighting the fact that policy choices matter, the *Survey* recommends that countries respond aggressively in order to minimize the reversal of hard-won gains rather than end up with “too little, too late”.

In building further on these insights, the *Survey* proposes illustrative policy packages that are focused on aligning recovery with the 2030 Agenda for Sustainable Development in order to recover better together and protect development gains. Specifically, this package analyses three policy areas – social services, digital access and green development – and examines a range of policy options to meet immediate and medium-term financing needs for building such resilience. Governments are advised to focus on financing options that leverage their strengths and are implementable in view of their institutional capacities. However, in several instances individual Governments will also need to engage closely with international development partners as well as the private sector.

A blue ink signature of Armida Salsiah Alisjahbana.

**Armida Salsiah Alisjahbana**

Under-Secretary-General of  
the United Nations and  
Executive Secretary of ESCAP

COVID-19 is a shock like no other, and requires a response like no other. The time is now for the Asia-Pacific region to seize this opportunity to speed up and make its transition towards more resilient, equal and green development the centerpiece of the post-pandemic economic recovery.

# EXECUTIVE SUMMARY

The COVID-19 pandemic has exposed chronic development fault lines in Asia and the Pacific, taking a heavy toll on the social and economic well-being of the region's people. Slow regional progress in implementing the transformative 2030 Agenda for Sustainable Development has done little to reduce wide gaps in social services, digital access and green development, and that has exacerbated the vulnerability to such shocks.

The pandemic caused unprecedented socioeconomic disruptions in Asia and the Pacific. Working-hour losses totalled the equivalent of 140 million full-time jobs in 2020, while prolonged school closures severely affected education. Taken together, these distortions are likely to have considerable adverse effects on human capital accumulation and productivity. The poor and vulnerable groups were disproportionately affected, resulting in a surge in poverty and a widening of inequality gaps. ESCAP estimates that an additional 89 million people in the region could have been pushed back into extreme poverty at the \$1.90 per day threshold, erasing years of progress in poverty reduction.

The haphazard and less-than-adequate response by Governments to such a shock highlights the urgency to rethink economic policymaking, which has so far been focused primarily on economic growth, neglecting critical investments in people and in building resilience. To this end, the *Survey for 2021* takes stock of the socioeconomic fallout from the current pandemic and looks at past economic and non-economic shocks that have inflicted damage on the region's sustainable development prospects in order to draw lessons on how to *build forward better* during the post-pandemic recovery. It presents the contours of policy packages that are needed in this regard and analyses the impact of implementing them across the economic, social and environmental dimensions of sustainable development.

## *Uncertain turnaround after an unprecedented recession*

Developing countries in Asia and the Pacific registered their weakest economic performance since at least 1990, with an estimated 1.0 per cent output contraction in 2020, although this is somewhat better than the 1.8 per cent contraction expected earlier. A relatively quick turnaround in East and North-East Asia and parts of South-East Asia, supported by more effective pandemic control, swift recovery of domestic production and strong merchandise export performance, are the main reasons for this revised assessment. However, prolonged COVID-19 outbreaks, pre-pandemic economic challenges and structural vulnerabilities, including considerable exposure to contact-intensive and informal sectors, contributed to the slower and uneven recovery in other parts of the region. Parallel shocks of an oil price crash in early 2020 and natural disasters further exacerbated the recession in oil-exporting economies in the region and disaster-affected countries, especially in the Pacific subregion. While the Asia-Pacific region's least developed countries as a whole maintained positive economic growth in 2020, greater employment vulnerability, lower income levels, thinner fiscal buffers and inadequate social security coverage resulted in considerable development setbacks for them.

**The *Survey for 2021* is cautiously optimistic on the economic outlook for 2021/22.** Developing Asia-Pacific economies are forecast to grow by 5.9 per cent in 2021 and 5.0 per cent in 2022. However, for

most countries, the rebound will not be enough to compensate for the output loss in 2020. Moreover, there are **considerable uncertainties and downside risks**. The pandemic remains far from being fully contained in Asia and the Pacific, with the emergence of new hotspots and the reintroduction of stringent lockdowns in several countries. The rollout of COVID-19 vaccines is subject to multiple challenges and will be highly uneven across countries, with most developing countries expecting to achieve effective protection only by 2022. A “K-shaped recovery” is likely, with poorer countries and more vulnerable groups being marginalized in the post-pandemic recovery and transition period.

**A confluence of macroeconomic risks and trade tensions also weigh on the economic outlook.**

The fiscal response to the pandemic alongside excessive financial leveraging and subdued long-term productivity could jeopardize fiscal sustainability and add to the risk of future stagflation. At the same time, ongoing trade frictions and the process of “tech-decoupling” pose challenges to export prospects and regional value chains.

**Near-term macroeconomic policies need to prioritize pandemic control and back an inclusive recovery.**

A focus on inclusiveness would support more synchronized COVID-19 vaccination across countries, saving huge potential economic and human costs by shortening the pandemic threat to all. An inclusive recovery would also mitigate the risk of post-pandemic inequality and social unrest, and better support the recovery of aggregate demand. Policy continuity in fiscal and monetary support to consolidate the recovery and lay down a solid foundation for future development is essential. In view of the reduced fiscal space, an effort to strengthen policy quality and development synergies is required for greater developmental payoffs. In addition, Asia and the Pacific should harness regional cooperation and economic integration to better navigate post-pandemic uncertainties and respond to ongoing challenges in global trade and value chains.

## ***Understanding resilience: lessons from past crises and recoveries***

The Asia-Pacific region faces a complex risk landscape, or “risk-scape”. The far-reaching effects of the COVID-19 pandemic are a reminder that policymakers can no longer work in silos to separately consider “economic” and “non-economic” shocks and outcomes. Health emergencies and climate disasters are also economic risks, while financial crises and trade shocks can reverse hard-won gains on the social and environmental fronts. This calls for a more comprehensive approach to building resilience in line with the ambitions of the 2030 Agenda for Sustainable Development.

**Drawing lessons from the region’s past crises and recoveries, the Survey for 2021 finds that all adverse shocks result in permanent losses across the three dimensions of sustainable development.**

For instance, following a financial crisis, investment collapsed by nearly 20 per cent in the first year and failed to return to the pre-crisis level even after five years. Similarly, the unemployment rate and income Gini coefficient increased considerably following such epidemics as SARS, H1N1 and MERS, possibly due to uncertainty and reallocation effects in the labour market as well as unequal access to health care. Environmental performance, as measured by a composite index, also deteriorated in the wake of adverse shocks, undoing up to five years of progress. Natural disasters could generate waste and pollution, while economic shocks could prompt businesses and households to cut down spending on energy efficiency measures.



Given such dire implications of shocks, a key question is: to what extent can policy choices reduce setbacks and long-term scars? **Based on the region's own experience, the Survey for 2021 finds that economic policy choices and external financing options can determine the shape of recovery.** For instance, Asia-Pacific countries were more resilient to the 2008 global financial crisis because they responded with countercyclical fiscal and monetary stimulus instead of adopting abrupt fiscal consolidation and interest hikes as had happened during the 1997 Asian financial crisis. Similarly, remittances and official aid played a crucial cushioning role and helped avoid sharp increases in extreme poverty in the wake of natural disasters and terms-of-trade shocks.

**Furthermore, the Survey for 2021 finds that pre-existing vulnerabilities can amplify shocks and make recoveries more difficult.** In the wake of epidemics/pandemics and trade shocks, countries that had low health and social protection expenditures and widespread vulnerable employment faced larger setbacks in economic growth, poverty, inequality and human capital. Natural disasters had a more devastating impact on countries with low-quality infrastructure and less diversified economies. Without good roads and telecommunications, disaster relief could be delayed and economic disruptions prolonged. Less diversified economies may also find it challenging to adapt to shocks in the medium term.

Over time, the development trajectories of countries could diverge not only because of the varying risks they face but also because of how they manage such risks. Given that adverse shocks affect economic, social and environmental outcomes, progress on implementing the entire 2030 Agenda for Sustainable Development could be at risk. The Survey for 2021 finds that, on average, a financial crisis lowers GDP per capita by less than 1 per cent in countries that respond aggressively to shocks and have low pre-existing vulnerabilities compared with more than 3 per cent in other countries. An epidemic sets back educational outcomes by half a year in the former countries compared with a year and a half in the latter. A natural disaster sets back environmental performance by less than a year in the former countries compared with more than six years in the latter.

In the light of these findings, **the Survey for 2021 makes three recommendations with regard to dealing with a variety of economic and non-economic shocks.** First, *countries should respond aggressively to adverse shocks in order to minimize the reversal of hard-won gains.* To safeguard sustainable development in times of crisis, countries should opt for a strong and swift response rather than end up with "too little, too late". Second, *risk management should become part and parcel of development planning and policymaking.* Policymakers should assess how persistent and cross-cutting are the likely impacts of shocks and identify pre-crisis and post-crisis measures that will enhance resilience. Third, *international assistance should be strengthened towards least developed countries that suffer from a significant "resilience gap".* Developed countries need to fulfill their commitments on ODA and climate finance, which would go a long way in scaling up long-term investments and addressing these countries' vulnerability to external shocks.

## ***Policy package to build resilience: ensure universal access to health care and social protection, close the digital divide and strengthen climate and energy actions***

The COVID-19 pandemic triggered an unprecedented fiscal response, with \$4.3 trillion (12.8 per cent of 2019 GDP) being spent in Asia and the Pacific (\$1.8 trillion – 6.6 per cent of 2019 GDP, excluding Australia, Japan and New Zealand). Still, the initial optimism that such spending could help make economies resilient, inclusive and greener has been largely belied. For example, only a handful of the measures to restore economic growth momentum have supported gender equality, and a large part of the spending encourages more production and consumption of fossil fuels without green commitments. In sum, there remains considerable room for Asia and the Pacific to build forward towards a better future.

In going forward, countries should prioritize a better alignment of the COVID-19 recovery packages with the 2030 Agenda. The *Survey for 2021* proposes an illustrative policy package that seeks to ensure universal access to health care and social protection, close the digital divide and strengthen climate and energy actions. **It estimates that this “building forward better” package could reduce the number of poor people in the region by almost 180 million and cut carbon emissions by about 30 per cent in the long run. Importantly, the package does not necessarily add much fiscal burden if it is accompanied by bold policy actions**, such as ending fuel subsidies and introducing a carbon tax. Yet, public debt sustainability could be at risk for some less developed Asia-Pacific countries, which need to increase their spending by as much as 24 per cent of GDP per year in order to deliver such a package.

## ***Financing the “building forward better” package: exploring the potential of various options***

The *Survey for 2021* examines selected policy options to meet immediate and medium-term financing needs. These include debt service suspensions, debt swaps for development, sovereign bond financing, public debt management, emergency financing mechanisms and sustainable investing by public institutional investors. Although some progress has been made, there remains large potential for less developed Asia-Pacific countries to leverage these policy options. Among others, they should engage more actively in dialogues with official and multilateral creditors to benefit from debt service suspensions. Under the right conditions, offshore sovereign bonds and diaspora bonds can also be viewed as low-hanging fruit for several countries. At the same time, renewed interest in debt swaps for development could bring about significant debt relief impacts if, based on past lessons, the scale and design of these agreements are enhanced. To benefit from these opportunities, developing Asia-Pacific economies need to make their debt management and reporting more transparent in order to reaffirm their commitments to meet debt obligations.

As the available policy options are vast and diverse, Governments of countries in the Asia-Pacific region need to focus on the options that leverage their strengths and are implementable given their institutional capacity. Sole actions by Governments, however, are unlikely to be adequate. To *build forward better together*, multilateral cooperation not only matters but also is essential. The full potential of fiscal and financing policies discussed in the *Survey* for 2021 can be realized only when different Asia-Pacific countries and their international development partners work closely together as creditors and debtors, investors and investees, and guarantors and beneficiaries. More broadly, the private sector, including asset owners and managers, financial institutions and corporations, needs to step up its contributions to achieve more resilient, equal and green development.

### ***Powering through the pandemic: policymaking must not lose sight of building resilience***

The COVID-19 pandemic is a crisis like no other. Yet, it offers opportunities like no other. Being forced to adjust, the Asia-Pacific region has seen lives, workplaces and habits being transformed in fundamental ways. People are risking their lives on behalf of others, and there has been a reduction in air pollution and greenhouse gas emissions. It is high time that the Asia-Pacific region begins investing in laying the foundations of resilient well-being of people and the planet.

*The transition towards more resilient and sustainable economies should become an integral pillar in the post-pandemic economic recovery phase, following a differentiated strategy across countries.* It is understandable that the initial policy responses to the pandemic were focused on mitigating its immediate harmful impacts, but building up defense against future shocks would require more forward-looking policies. In particular, countries better resourced and more prepared to reap the economic synergies from climate actions should be the champions and lead by example.

A spirit of multilateralism and collaboration is also essential. For pandemic control, Asia and the Pacific is ideally positioned for regional cooperation to complement the global effort to ensure more even progress across countries in COVID-19 vaccination programmes. Further regional alliances, such as the Regional Comprehensive Economic Partnership free trade agreement, could also open new economic opportunities and strengthen the region's resilience to external shocks.

# ENHANCING RESILIENCE IS CRITICAL TO SUSTAINABLE DEVELOPMENT OF ALL COUNTRIES

The pandemic will leave long-term scars on economies, societies and the environment



**89 million** people  
back to extreme poverty

The Asia-Pacific region  
faces a complex risk  
landscape



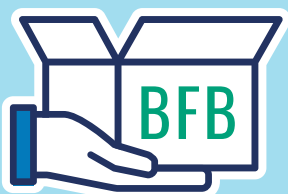
Adverse shocks reverse  
hard-won gains across the  
three dimensions



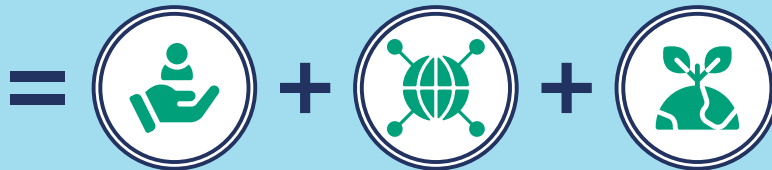
Vulnerabilities can  
amplify shocks, but policies  
can help reduce setbacks

ESCAP proposes a package

Reduce the number of poor  
by **180 million**



Building Forward Better



Social services

Digital access

Green development

Selected policy options to meet financing needs



Debt service  
suspensions



Debt swaps for  
development



Sovereign bond  
financing



Public debt  
management



Emergency  
financing



Sustainable  
investing by  
institutional investors

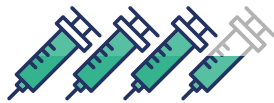


# ONLY AN INCLUSIVE RECOVERY IS A ROBUST RECOVERY

There is risk of a **K**-shaped recovery

## Developed

3.6 doses per person



**VACCINE  
ORDERS**

24.3% of GDP



**FISCAL  
STIMULUS**

> 80% of population  
have access to Internet



**ACCESS TO DISTANCE  
LEARNING**

27% of the labour force



**CHANCES FOR  
TELEWORKING**

## Developing

0.5 doses per person



1.7-6.6% of GDP



<30% of population  
have access to Internet



12% of the labour force



## An inclusive recovery would deliver **3** benefits

①



**Shorten  
pandemic  
threat for all**

②



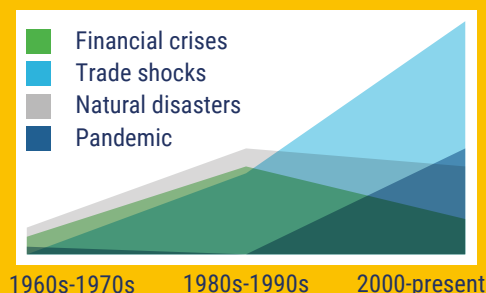
**Reduce risk of  
post-pandemic  
unrest**

③



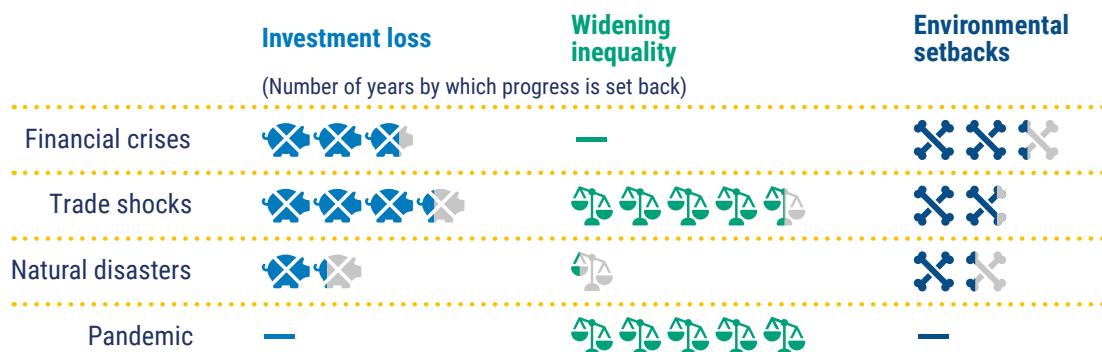
**Most effectively  
support rebound in  
aggregate demand**

**Asia-Pacific region's complex risk landscape calls for a comprehensive approach to enhancing resilience.**

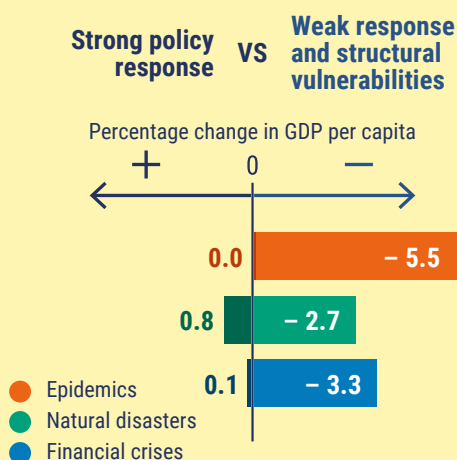


# LEARNING RESILIENCE FROM PAST CRISES AND RECOVERIES

**From financial crises to natural disasters, all adverse shocks reverse hard-won gains across the three dimensions of sustainable development.**



**Countercyclical fiscal and monetary responses and foreign aid reduce the setback, but weak social services and infrastructure amplify shocks.**



**Least developed countries have limited capacity to respond to shocks and face wide "resilience gaps".**

- Least developed countries
- Other developing countries
- OECD countries

**Sovereign credit rating index**



**Social protection spending (% of GDP)**



**Infrastructure quality index**



# Policy package to enhance resilience: Building Forward Better



## SOCIAL SERVICES



## DIGITAL ACCESS



## GREEN DEVELOPMENT



## SPENDING SCENARIOS

### Ambitious Scenario

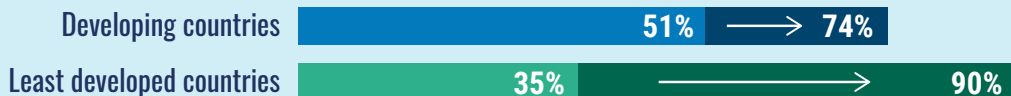


### Business-as-usual Scenario



## Fighting pandemic + Investing in "Building Forward Better"

Public debt-to-GDP ratio 2019 → 2030



## Selected policy options to meet financing needs



Debt service suspensions



Debt swaps for development



Sovereign bond financing



Public debt management



Emergency financing



Sustainable investing by institutional investors

# ACKNOWLEDGEMENTS

The *Economic and Social Survey of Asia and the Pacific* is a flagship publication of the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP). Published annually since 1947, the *Survey* has for decades been a valuable companion for policymakers, civil society, academia and other stakeholders in the Asia-Pacific region, providing forward-looking analyses and recommendations on economic conditions and key sustainable development challenges.

The *Survey* is produced under the direction of the Executive Secretary and the Editorial Board of ESCAP, with contributions of staff from its substantive divisions and subregional offices. It draws on expertise available from across the United Nations system.

This 2021 edition of the *Survey* was prepared by a core team led by Sweta C. Saxena, including Nixie Abarquez, Shuvojit Banerjee, Zhenqian Huang, Zheng Jian, Daniel Jeong-Dae Lee, Kiatkanid Pongpanich, Vatcharin Sirimaneetham and Lin Zhuo of the Macroeconomic Policy and Financing for Development Division.

Kaveh Zahedi, Deputy Executive Secretary of ESCAP, and Hamza Ali Malik, Director of the Macroeconomic Policy and Financing for Development Division, provided overall guidance and management.

ESCAP staff who provided valuable inputs and feedback include: Hongpeng Liu and Michael Williamson (Energy Division); Stefanos Fotiou, Aneta Nikolova and Katinka Weinberger (Environment and Development Division); Tiziana Bonapace, Madhurima Sarkar-Swaisgood and Sanjay Srivastava (Information and Communications Technology and Disaster Risk Reduction Division); Van Nguyen and Yusuke Tateno (Office of the Executive Secretary); Sabine Henning and Ermina Sokou (Social Development Division); Eric Hermouet and Gemma Van Halderen (Statistics Division); Mia Mikic and Michal Podolski (Trade, Investment and Innovation Division); Sanjesh Naidu (ESCAP Subregional Office for the Pacific); and Nagesh Kumar and Rajan Ratna (ESCAP Subregional Office for South and South-West Asia). Helpful suggestions were also received from Christian Viegelahn (ILO); and Rodrigo Carcamo and Nicolas Maystre (UNCTAD).

The report benefited from extensive debates among and suggestions from a group of policymakers, academic scholars, private sector participants and development practitioners who acted as external peer reviewers and/or provided inputs at the Virtual Expert Group Meeting held from 16 to 18 November 2020 and on other occasions. *From government ministries, national agencies, central banks, think-*



*tanks, private organizations and academia*, they include: Muhamad Chatib Basri (CReco Research, Indonesia); Baur Bektemirov (AIFC Authority, Kazakhstan); Gil Beltran (Department of Finance, Philippines); N.R. Bhanumurthy (Bengaluru Dr. B.R. Ambedkar School of Economics University, India); Freddy A. Rojas Cama (Bay Atlantic University, United States); P.G. Dhar Chakrabarti (National Disaster Management Authority, India); Iris Claus (*Journal of Economic Surveys*); Dawn Holland (National Institute of Economic and Social Research, United Kingdom); Hyun-Hoon Lee (Kangwon National University, Republic of Korea); Patricia Mongkhonvanit (Public Debt Management Office, Thailand); Daniel Munevar (EURODAD, Belgium); Yerulan Mustafin (National Bank of Kazakhstan); Ilan Noy (Victoria University of Wellington, New Zealand); Wenxing Pan (AMRO, Singapore); Pisit Puapan (Ministry of Finance, Thailand); Denton Rarawa (Pacific Islands Forum Secretariat, Fiji); Hannah Ryder (Development Reimagined, China); Dushni Weerakoon (Institute of Policy Studies of Sri Lanka); and Siu Fung (Matthew) Yiu (AMRO). *From the United Nations and other international organizations*, they include: Abdul Abiad (Asian Development Bank); Gong Cheng and Ilhyock Shim (Bank for International Settlements); Alistair Dieppe (European Central Bank); Sara Elder (International Labour Organization); Holger van Eden (International Monetary Fund); Atsuko Okuda (International Telecommunications Union); Franziska Ohnsorge (World Bank); and Peter Cowley (World Health Organization).

The following consultants provided substantive inputs: Freddy A. Rojas Cama, Dawn Holland, Mohammad Shadan Khan, Roger Kronenberg and Charan Singh.

Chawarin Klongdee provided excellent research assistance. Sutinee Yeamkitpibul proofread the manuscript. Both, who are from the Macroeconomic Policy and Financing for Development Division, provided valuable administrative assistance, including support for the publication's launch.

ESCAP Interns – Gabriele Bowen, Elena Herold, Jing Luo, Christopher Shim and Tatjana von Peter – provided inputs to the report and excellent research assistance.

The manuscript was edited by John Loftus. The graphic design and layout were created by Xiao Dong. The printing was provided by Clung Wicha Press Co., Ltd.

Mitch Hsieh, Katie Elles, Christophe Manshoven and Kavita Sukanandan, all from the ESCAP Communications and Knowledge Management Section, coordinated the media launch and dissemination of the report. Mahesh Uniyal supported the dissemination of the report.

# EXPLANATORY NOTES

Analyses in the *Economic and Social Survey of Asia and the Pacific 2021* are based on data and information available up to 9 March 2021.

Groupings of countries and territories/areas referred to in the present issue of the *Survey* are defined as follows:

- **ESCAP region:** Afghanistan; American Samoa; Armenia; Australia; Azerbaijan; Bangladesh; Bhutan; Brunei Darussalam; Cambodia; China; Cook Islands; Democratic People's Republic of Korea; Fiji; French Polynesia; Georgia; Guam; Hong Kong, China; India; Indonesia; Iran (Islamic Republic of); Japan; Kazakhstan; Kiribati; Kyrgyzstan; Lao People's Democratic Republic; Macao, China; Malaysia; Maldives; Marshall Islands; Micronesia (Federated States of); Mongolia; Myanmar; Nauru; Nepal; New Caledonia; New Zealand; Niue; Northern Mariana Islands; Pakistan; Palau; Papua New Guinea; Philippines; Republic of Korea; Russian Federation; Samoa; Singapore; Solomon Islands; Sri Lanka; Tajikistan; Thailand; Timor-Leste; Tonga; Turkey; Turkmenistan; Tuvalu; Uzbekistan; Vanuatu; and Viet Nam.
- **Developing ESCAP region:** ESCAP region excluding Australia, Japan and New Zealand.
- **Developed ESCAP region:** Australia, Japan and New Zealand.
- **East and North-East Asia:** China; Democratic People's Republic of Korea; Hong Kong, China; Japan; Macao, China; Mongolia; and the Republic of Korea.
- **North and Central Asia:** Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Russian Federation, Tajikistan, Turkmenistan and Uzbekistan.
- **Pacific:** American Samoa, Australia, Cook Islands, Fiji, French Polynesia, Guam, Kiribati, Marshall Islands, Micronesia (Federated States of), Nauru, New Caledonia, New Zealand, Niue, Northern Mariana Islands, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu.
- **Pacific island developing economies:** All those listed above under "Pacific" except for Australia and New Zealand.
- **South and South-West Asia:** Afghanistan, Bangladesh, Bhutan, India, Iran (Islamic Republic of), Maldives, Nepal, Pakistan, Sri Lanka and Turkey.
- **South-East Asia:** Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, Timor-Leste and Viet Nam.

- **Least developed countries:** Afghanistan, Bangladesh, Bhutan, Cambodia, Kiribati, Lao People's Democratic Republic, Myanmar, Nepal, Solomon Islands, Timor-Leste and Tuvalu. Samoa and Vanuatu were part of the least developed countries prior to their graduation in 2014 and 2020, respectively.
- **Landlocked developing countries:** Afghanistan, Armenia, Azerbaijan, Bhutan, Kazakhstan, Kyrgyzstan, Lao People's Democratic Republic, Mongolia, Nepal, Tajikistan, Turkmenistan and Uzbekistan.
- **Small island developing States:** American Samoa, Cook Islands, Fiji, Kiribati, French Polynesia, Guam, Kiribati, Maldives, Marshall Islands, Micronesia (Federated States of), Nauru, Niue, Northern Mariana Islands, Palau, Papua New Guinea, Samoa, Singapore, Solomon Islands, Timor-Leste, Tonga, Tuvalu and Vanuatu.

Due to the limited availability of data, selected small island developing States are excluded from the analysis. For the purpose of this Report, Singapore is not considered to be a small island developing State due to its high level of development and high-income status.

Bibliographical and other references have not been verified. The United Nations bears no responsibility for the availability or functioning of URLs.

Many figures used in the *Survey* are on a fiscal year basis and are assigned to the calendar year which covers the major part or second half of the fiscal year.

Growth rates are on an annual basis, except where indicated otherwise.

References to dollars (\$) are to United States dollars, unless otherwise stated.

The term "billion" signifies a thousand million. The term "trillion" signifies a million million.

In the tables, two dots (..) indicate that data are not available or are not separately reported; a dash (–) indicates that the amount is nil or negligible; and a blank indicates that the item is not applicable.

In dates, a hyphen (-) is used to signify the full period involved, including the beginning and end years, and a stroke (/) indicates a crop year, fiscal year or plan year.

# ACRONYMS

<b>ACT</b>	Access to COVID-19 Tools Accelerator
<b>ADB</b>	Asian Development Bank
<b>ALMP</b>	active labor market policy
<b>AMC</b>	advance market commitment
<b>ASEAN</b>	Association of Southeast Asian Nations
<b>BIS</b>	Bank for International Settlements
<b>CABB</b>	cyclically adjusted budget balance
<b>CEO</b>	chief executive officer
<b>CO<sub>2</sub></b>	carbon dioxide
<b>COVAX</b>	COVID-19 Vaccine Global Access Facility
<b>COVID-19</b>	coronavirus disease 2019
<b>CPTPP</b>	Comprehensive and Progressive Agreement for Trans-Pacific Partnership
<b>DAC</b>	Development Assistance Committee
<b>DSSI</b>	G20 Debt Service Suspension Initiative
<b>ECB</b>	European Central Bank
<b>ECLAC</b>	Economic Commission for Latin America and the Caribbean
<b>EM-DAT</b>	International Disaster Database, or Emergency Events Database
<b>EPI</b>	Environmental Performance Index
<b>ESCAP</b>	United Nations Economic and Social Commission for Asia and the Pacific
<b>ESG</b>	environmental, social and governance
<b>EU</b>	European Union
<b>EVI</b>	economic vulnerability index
<b>FAO</b>	Food and Agriculture Organization of the United Nations



<b>FDI</b>	foreign direct investment
<b>FTA</b>	free trade agreement
<b>G20</b>	Group of Twenty
<b>GDP</b>	gross domestic product
<b>GHG</b>	greenhouse gas
<b>GIIN</b>	Global Impact Investing Network
<b>GNI</b>	gross national income
<b>GVC</b>	global value chain
<b>H1N1</b>	haemagglutinin (H1) neuraminidase (N1); an orthomyxovirus subtype, which infects birds, pigs and humans, causing influenza A
<b>HDI</b>	Human Development Index
<b>IDR</b>	Indonesian rupiah
<b>IEA</b>	International Energy Agency
<b>ILO</b>	International Labour Organization
<b>ILOSTAT</b>	ILO Labour Statistics
<b>IMF</b>	International Monetary Fund
<b>LDC</b>	least developed country
<b>MERS</b>	Middle East respiratory syndrome
<b>NGFS</b>	Network of Central Banks and Supervisors for Greening the Financial System
<b>NO<sub>x</sub></b>	nitrogen oxides
<b>ODA</b>	official development assistance
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>OMFIF</b>	Official Monetary and Financial Institutions Forum
<b>OPEC</b>	Organization of the Petroleum Exporting Countries
<b>PBOC</b>	People's Bank of China
<b>PEFA</b>	Public Expenditure and Financial Accountability programme
<b>PHP</b>	Philippine peso

<b>PPE</b>	personal protective equipment
<b>QE</b>	quantitative easing
<b>Q1</b>	first quarter of a year
<b>Q2</b>	second quarter of a year
<b>Q3</b>	third quarter of a year
<b>Q4</b>	fourth quarter of a year
<b>RCEP</b>	Regional Comprehensive Economic Partnership
<b>R&amp;D</b>	research and development
<b>SAARC</b>	South Asian Association for Regional Cooperation
<b>SARS</b>	severe acute respiratory syndrome
<b>SDGs</b>	Sustainable Development Goals
<b>SEACEN</b>	South East Asian Central Banks
<b>SEEA</b>	System of Environmental-Economic Accounting
<b>SFP</b>	self-financing participants
<b>SME</b>	small and medium-sized enterprise
<b>SO<sub>2</sub></b>	sulphur dioxide
<b>SWIID</b>	Standardized World Income Inequality Database
<b>TCFD</b>	Task Force on Climate-related Financial Disclosures
<b>UNCTAD</b>	United Nations Conference on Trade and Development
<b>UNDP</b>	United Nations Development Programme
<b>UNEP</b>	United Nations Environment Programme
<b>UNICEF</b>	United Nations Children's Fund
<b>UNDRR</b>	United Nations Office for Disaster Risk Reduction
<b>UN-OHRLLS</b>	United Nations Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States
<b>UNSDG</b>	United Nations Sustainable Development Group
<b>UNU-WIDER</b>	World Institute for Development Economics Research of the United Nations University
<b>WHO</b>	World Health Organization
<b>WTO</b>	World Trade Organization

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# Chapter 1

## Building Resilience Requires Change

### 1. Rethinking economic policymaking for building resilience

The unprecedented toll of the COVID-19 pandemic on people's health and economic well-being has exposed how unprepared the world is for such systemic shocks, shining a spotlight on the glaring socioeconomic divides that are at the root of weakened resilience.

The pandemic is exacerbating some already existing weaknesses and vulnerabilities in the Asia-Pacific region. For instance, lockdowns have required many people to work from home and students to use online classrooms in a region where only 50 per cent of the population has access to the Internet and a large part of the labour force is in the informal sector. Consequently, at least 150 million school children in South Asia and 80 million in the UNICEF East Asia and Pacific region cannot be reached by digital and broadcast remote learning programs developed to deal with school closures. Those numbers account for about half the global total (UNICEF, 2020).<sup>1</sup>

The apparent trade-off between saving lives and livelihoods by enforcing strict lockdowns, with consequent job and income losses, especially for informal workers, and the heavy strain on public health systems has highlighted yet again the urgency of rethinking the economic growth-centred development paradigm.<sup>2</sup> Over the last few decades, an almost exclusive focus by policymakers on economic expansion, typically measured by growth in GDP, has led to the neglect and

<sup>1</sup> For detailed information, see a global analysis of the potential reach of remote learning policies, available at <https://data.unicef.org/resources/remote-learning-reachability-factsheet/>.

<sup>2</sup> See ESCAP (2020a). For a discussion on how the call to think beyond just expansion of economic output after the 2008 global financial crisis was missed and on the repercussions of that lost opportunity for the current pandemic, see Huang and Saxena (2021).





weakening of buffers against economic and non-economic shocks. Inadequate public investments in health, education and sustainable development in general left the region grossly unprepared for the public health crises and socioeconomic costs arising as a consequence of the ongoing pandemic.

The emphasis on economic growth is misplaced as such growth does not necessarily improve the overall well-being of people. This is evident in the low rankings of Asia-Pacific economies listed in the *World Happiness Report*<sup>3</sup> as well as in the high levels of mental stress (more than 100 million people suffer from mental health disorders in the WHO Western Pacific Region).<sup>4</sup>

**The economic growth-centred policymaking that has become a mainstream approach to development has left countries unprepared to deal with the pandemic and build resilient economies**

The adverse consequences of too much focus on efficient utilization of resources – the underlying principle of prevalent economic thinking – stood out during the ongoing pandemic. For instance, emphasis on production efficiency led to the proliferation of global value chains (GVCs) – an international production-

sharing arrangement, where production is divided into activities and tasks carried out in different countries. Although this did create economic opportunities and contributed to economic prosperity, it had some drawbacks too.<sup>5</sup> With each task relying on inputs from another country, strict lockdowns across borders brought these GVCs to a standstill. Sectors that relied heavily on extended supply chains, such as automobiles, pharmaceuticals and electronics, experienced high stress due to supply shortages. It has come to the forefront that the resilience of production was compromised in the name of efficiency.

Additionally, such exclusive focus on efficiency only guarantees optimum use of resources to increase the size of the pie, but is not necessarily concerned with how the pie is divided and distributed (inclusivity concerns) or produced (environmental implications).<sup>6</sup> For instance, manufacturing relocated from labour-expensive advanced countries to developing countries (mainly in Asia) where wages are low and environmental legislation or its enforcement is minimal. While this shift employed millions, bringing them out of extreme poverty, it had adverse implications for the environment. For instance, producing garments in Bangladesh at low cost for consumers in North America and Europe, while lifting millions out of extreme poverty in Bangladesh, has led to a water crisis in that country,<sup>7</sup> a situation not conducive to fighting a pandemic where hygiene is important and water is essential. This phenomenon is tantamount to reverse wealth transfer to industrial countries, as poor countries provide cheap labour and the environmental costs are not borne by the final consumers in advanced countries.

An almost exclusive focus on efficiency and emphasis on self-interest and markets, with minimum or no government intervention, has created many of the socioeconomic fault lines exposed by the pandemic.

- Businesses know best: Fifty years ago, Friedman (1970) wrote that the only social responsibility of business is to increase profits and value for shareholders.<sup>8</sup> This

3 In the 2020 issue, the highest-ranking country among non-industrial Asia-Pacific countries was Singapore with a ranking of 31.

4 Mental health is a state of well-being in which an individual realizes his or her own abilities, can cope with the normal stresses of life, can work productively and is able to make a contribution to his or her community, according to WHO. There are inseparable links between mental and physical health. For further information, see [www.who.int/westernpacific/health-topics/mental-health#](http://www.who.int/westernpacific/health-topics/mental-health#).

5 The various adverse social and environment consequences of GVCs are a source of ongoing debates. However, these issues are beyond the scope of discussion here.

6 See ESCAP (2020a), which elaborates on the Asia-Pacific region's regression on Sustainable Development Goal 12 – Ensure sustainable consumption and production patterns.

7 Garment production is a very resource-intensive process.

8 A digitized version of his 13 September 1970 New York Times article, entitled "A Friedman doctrine—the social responsibility of business is to increase its profits", is available at [www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html](http://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html).



emphasis on pure economic profit maximization comes at the cost of social and environmental well-being, as wages are kept at bay and environmental damage is excluded from cost calculations. Moreover, such reported profits appear to be “fake”. The immiseration of workers became more apparent during the ongoing pandemic, when large businesses needed workers to provide delivery services but did not furnish them with adequate protection against infection.<sup>9</sup>

- An economic growth-centric narrative as well as the influence of elites keep short-termism alive, and the Asia-Pacific region is no exception in this regard. While rich and politically connected people, broadly referred to as elites, maintain the status quo,<sup>10</sup> an economic growth-centric narrative also feeds into short-termism on the part of Governments. For one, it makes it harder for them to institute structural reforms and introduce initiatives that help build resilience, as such measures often tend to have an adverse impact in the short term, even if they are beneficial in the longer run. For instance, in a sample of 66 countries that included 14 from the Asia-Pacific region, Alesina and others (2020) showed that, even when liberalizing reforms engender benefits for the economy, they materialize only gradually over time. Partly because of this delayed effect, and possibly because voters are impatient or do not anticipate future benefits, liberalizing reforms are costly to incumbents when implemented close to the time of elections. Furthermore, policymakers have a harder time justifying strong structural reform initiatives to stop crises that have not happened. This means that policy failures are observable, but successes are not. Policymakers would find it difficult (based on actual results rather than forecasts) to defend potentially unpopular measures, precisely because they succeeded in avoiding crises. Such political calculations are responsible for the lack of investment in areas where results take longer to become manifest, such as education, health, social protection and infrastructure – all of which suffered during the pandemic. Additionally, climate change is a case of intergenerational justice: decisions on climate taken today affect future generations, but those generations are not here to vote

on it today – they have not even been born yet. Hence, it is a moral obligation of elected officials to mete out such justice; if they do not, the climate change “can” will keep getting kicked down the road. However, this should not be the case anymore, as mankind is now in the midst of a climate emergency (ESCAP, 2020a).

- The singular focus on shareholder value maximization has led to the neglect of the concerns of other stakeholders. One such issue is the adverse implications of increasing interactions that humans have with nature, resulting in not only environmental degradation but also the emergence of public health emergencies, such as the COVID-19 pandemic. Little attention has been paid to how coronaviruses, which are zoonotic, are transmitted between animals and people. Due to the process of urbanization, the natural habitat for wildlife is shrinking, thus increasing humans’ potential exposure to disease-causing zoonotic pathogens. Indeed, 75 per cent of all emerging infectious diseases come from wildlife.<sup>11</sup> To prevent future outbreaks, it is essential to address the threats to ecosystems and wildlife, including habitat loss, illegal trade, pollution and climate change. Additionally, natural disasters linked to climate change also disproportionately affect poor people and poor countries. The direct cost of zoonotic diseases over the period

<sup>9</sup> One way to get around such corporate behaviours is to mandate reporting on environmental, social and governance (ESG) issues.

<sup>10</sup> In his 2018 book, entitled *Winners Take All: The Elite Charade of Changing the World*, Anand Giridharadas documented how philanthropy by the rich has kept the status quo alive.

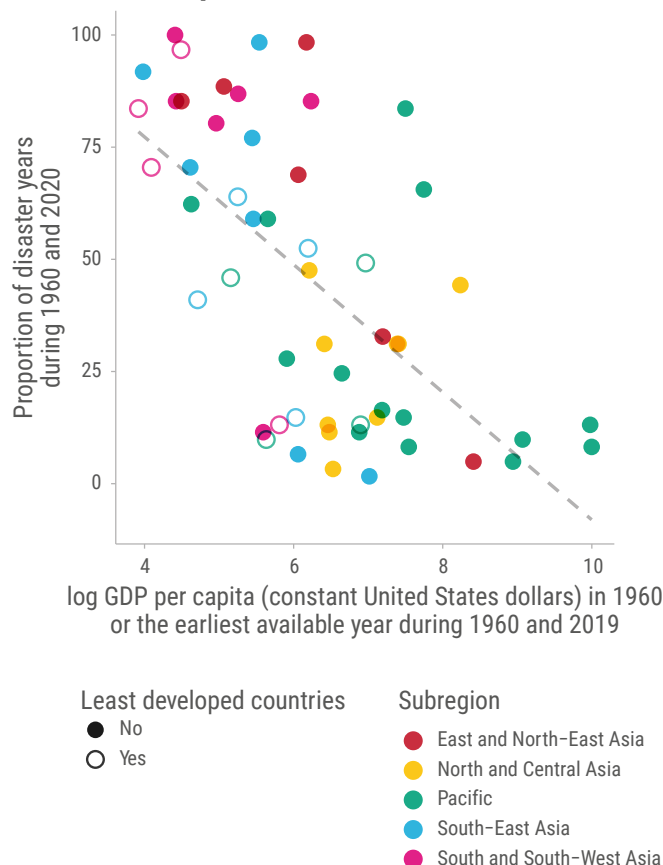
<sup>11</sup> For additional information, see [www.unenvironment.org/resources/working-environment-protect-people-covid-19-response](http://www.unenvironment.org/resources/working-environment-protect-people-covid-19-response).

2000-2010 has been estimated to be more than \$20 billion, with more than \$200 billion in indirect losses to affected economies as a whole (World Bank, 2010).<sup>12</sup> These costs are likely to be much higher now.

Asia and the Pacific missed the opportunity to correct course after the 2008 global financial crisis and advance sustainable development, as emphasis remained focused on reviving economic growth at any cost (Huang and Saxena, 2021). Consequently, inequality continued to rise and so did the unsustainable use of natural resources, outpacing economic growth. *Even before the start of the pandemic, income inequalities were exacerbating climate inequality.* The 10 per cent richest population of the world contributed 52 per cent of cumulative global carbon emissions, while the bottom 50 per cent accounted for only 7 per cent between 1990 and 2015. However, the cost of this rise in greenhouse gas (GHG) emissions is borne by poor people and developing countries, as the frequency of natural disasters rises with climate change, and they have less capacity to deal with such shocks. For instance, the proportion of years spent dealing with a natural disaster is higher for developing countries than it is for developed countries (figure 1.1). With the permanent impact of shocks on output levels (see chapter 3), each climate-related shock pushes the countries back from what was their likely economic growth trajectory. Rising global temperatures have

**Figure 1.1**

**The frequency of natural disasters and the level of economic development**



Source: The International Disaster Database, available at [www.emdat.be](http://www.emdat.be) (accessed on 15 October 2020); World Bank Open Data, available at <https://data.worldbank.org/> (accessed on 13 October 2020).

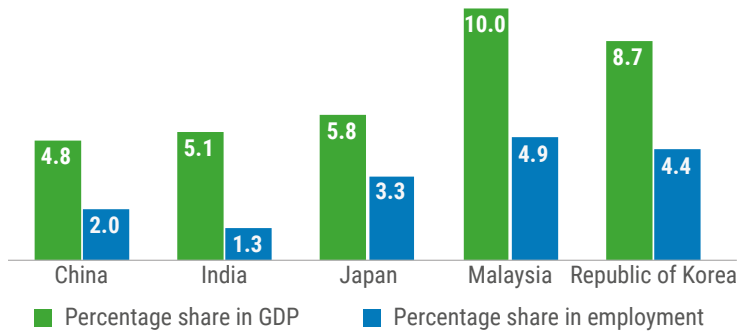
uneven macroeconomic effects, with adverse consequences concentrated in countries with relatively hot climates, such as most low-income countries, including those in the Asia-Pacific region. In these countries, a rise in temperature lowers per capita output in both the short and medium term by reducing agricultural output, suppressing the productivity of workers exposed to heat, slowing investment and damaging health (IMF, 2017). In a recent Stanford University study, it was found that the gap between the economic output of the world's richest and poorest countries is 25 per cent larger today than it would have been without global warming (Difffenbaugh and Burke, 2019).<sup>13</sup> Climate change can also worsen within-country inequality as the poor are likely to be

<sup>12</sup> For more information about the approach for controlling zoonotic diseases, see <https://openknowledge.worldbank.org/bitstream/handle/10986/2844/508330ESW0whit1410B01PUBLIC1PPP1Web.pdf?sequence=1&isAllowed=y>.

<sup>13</sup> For details about the study, see <https://earth.stanford.edu/news/climate-change-has-worsened-global-economic-inequality#gs.hl6jvi>.

**Figure 1.2****Technology (ICT) sector: a real disconnect?**

Value added by ICT to GDP and employment



Source: UNCTAD (2019a)

the most adversely affected. This is partly because climate risks decrease vulnerable populations' ability to absorb shocks as they try to cope by adopting such measures as decreasing their nutritional intake or removing children from school. Because climate change is an ongoing issue, failure to address it will continue to weaken economies' resilience, and the "price" that a common person pays could be higher than that experienced during the COVID-19 pandemic.<sup>14</sup>

### The "real" disconnect: economic growth enablers become economic growth drivers

With an excessive focus on efficiency and economic growth, its two enablers (technology and finance) have also become its sources, creating more fragility and weakening economic resilience.

For instance, the IT sector's contributions to GDP is at least twice its share in total employment (UNCTAD, 2019a). In developing countries with a surplus of labour, labour replacement with AI/robots/machines creates a dilemma, as raising productivity comes at the cost of creating jobs (figure 1.2).

There is also a significant digital divide in the Asia-Pacific region. More than half the region's population remains "unconnected". In parts of Central Asia, for example, less than

1 per cent of the population has a fixed broadband Internet subscription. This lack of access to both the Internet and the quality of broadband made both work-from-home and school-from-home – the only modalities that functioned during COVID-19 lockdowns – impossible for millions of employees and students (Huang and Saxena, 2020).

Similarly, by becoming the source of economic growth, finance, instead of enabling such growth, has created more fragilities through risk-taking while exacerbating inequalities.<sup>15</sup> While the importance of finance in recovery from financial crises is clear, its role in normal times in enhancing resilience and the overall well-being of economies is ambiguous (Haldane and Madouros, 2011). Instead of adding to real productive activity, the financial sector merely re-allocates risk, and the current framework to measure its contribution blurs the distinction between risk bearing and risk management. For instance, banks' value added to GDP from risk-bearing – the spread between loan and deposit rates on their loan book – increases as balance sheets expand. When they fail, however, they are bailed out with taxpayers' money. If raising taxes or lowering government revenues involves deadweight welfare costs, this transfer is actually welfare-reducing. That effect, too, is entirely missed by existing statistical measures of the contribution of the financial sector (Wang, 2011).

<sup>14</sup> Climate change is an impediment to building resilience in the case of developing countries because it increases financial risks through increases in sovereign credit risks due largely to weaker capacity to adapt to and mitigate the consequences of climate change. This in turn affects the credit worthiness of developing countries and the availability of finance. For further information, see Cevik and Jalles (2020).

<sup>15</sup> The recent unravelling of the short-selling of stocks, such as GameStop on the trading platform Robinhood, exemplifies the role that finance plays in (de)stabilizing markets: it has real effects.

## 2. Building resilience: economic, social and environmental

### The COVID-19 pandemic provides yet another opportunity to build a resilient future

It is a well-known empirical fact that both economic and non-economic shocks have permanent impacts on the level of output (Cerra and Saxena, 2008). In this issue of the *Survey* for 2021, we provide evidence on how these shocks set sustainable development back along social and environmental dimensions as well (chapter 3). For instance, we show that adverse shocks result in lower average income, wider income inequality, higher unemployment, slower accumulation of human and physical capital and weaker environmental performance.

Driven by a focus on efficiency rather than resilience, conventional economic theory does not suitably incorporate the impact of crises and adverse shocks on development. The neoclassical model of economic development predicts that poor countries, which are those with lower capital stocks, would grow faster than rich countries because of diminishing returns to capital. Hence, this implies convergence in per capita incomes. However, the development literature has found that empirical evidence contradicts the prediction of such convergence (Barro, 1991).

In looking deeper into expansions and contractions separately, Cerra and Saxena (2005; 2017) found that, in line with neoclassical growth theory,

economic expansions in poor countries are indeed stronger than in rich countries. In the absence of negative shocks, this could over time lead to a convergence in the levels of output per capita. However, recessions in rich countries are shallow and infrequent compared with those in poor countries. It may be the case that weaknesses in poor countries' policies and institutions are contributing to their underdevelopment, but it is the frequency and size of the crises and recessions that commonly set poor countries back from their development path.

Hence, it becomes important to build resilience into the development framework. While there is no common definition of "resilience", the term typically refers to the capacity of individuals, communities and countries to withstand, adapt to and recover from adverse shocks (ESCAP, 2013).

Building economic resilience to shocks can be anchored either in mitigation (i.e. tackling the cause and reducing its impact) or adaptation (i.e. anticipating shocks, building buffers and taking advantage of the opportunities that arise). Examples of shocks that illustrate the point are:

- (a) Pandemic: Mitigation may require changing human diets and interactions with animals (for zoonotic diseases), while adaptation would require more preparedness and public investment in the health sector;
- (b) Terms of trade: Mitigation may require diversifying the economy; adaptation would require instituting policy rules to manage the boom-bust cycles associated with terms of trade shocks;
- (c) Climate change: Mitigation means reducing GHG emissions by moving to renewable sources of energy; adaptation means building infrastructure that is resilient to climate change-induced natural disasters;
- (d) Financial shocks: Mitigation requires banks to build buffers against loans they make through macroprudential policies; adaptation means new legislation for disclosure or deposit insurance.

The varied impacts of shocks on development can be mitigated through effective policy measures, as has been learned from the past (chapter 3). Hence, it becomes even more important to respond proactively to adverse shocks in order to minimize setbacks. Countries with more supportive macroeconomic policies in times of crisis tend to recover faster and avoid deeper scars. At the same time, strong health

and social protection systems, quality of infrastructure and productive capability of the economy are important factors for resilience.

Minimizing the impact of shocks either through ex ante (mitigation) or ex post (adaptation) measures would require making investments to support the 2030 Agenda for Sustainable Development.<sup>16</sup> However, as shocks occur, income levels fall, which also leads to a drop in government tax revenues. This creates a dilemma for Governments on how to spend their way out of crises when their finances run low. To preserve fiscal sustainability, fiscal consolidation tends to follow such recessions, which is precisely the wrong medicine. In this vein, chapter 4 proposes a “*building forward better*” policy package that includes focus on social services, digital access and green development. Implementation of such a policy package will reduce poverty, inequality and environmental degradation. However, additional spending for such a resilient future will raise the level of debt in some countries. To this end, we suggest several financing options, ranging from exploring debt relief, sovereign bond financing, and public debt restructuring and management in the short run to enhancing national emergency financing mechanisms and increasing contributions to sustainable development by private finance in the medium term (chapter 5).

### 3. Policy agenda for resilience

Building resilience into policy frameworks and institutions would require aligning fiscal and monetary policies, along with structural reforms, with the 2030 Agenda. Among other considerations, this will require striking the right balance between status quo pragmatism and unrealistic idealism.

As will be argued in chapter 3, integrated policymaking is needed to build resilience against shocks. To tackle the two largest challenges of current times – inequality and climate change – policymakers can no longer work in silos. Rather both fiscal authorities and central banks should work in tandem towards these two goals.

#### 3.1. Investments in social services and digital infrastructure can reduce inequalities

According to White (2020), attention to distribution and social inclusion is required for a sustainable, democratic political system. The pandemic has laid bare the vulnerabilities

of the millions who do not have access to health services or social protection systems. A repeated occurrence of such shocks, along with persistent neglect of health and social protection systems, can undermine the confidence of people in a democratic political system. Hence, even if only to legitimize their own governance, Governments need to protect the most vulnerable by investing in universal health-care services, and social protection and climate-resilient infrastructure. Annual additional investments in the developing countries of the Asia-Pacific region needed to realize basic human rights (ending poverty and hunger) and human capabilities (universal education and health care) will cost \$668 billion (ESCAP, 2019b). The region also needs active labour market policies to prepare its labour force for the structural change that the global economy is undergoing, especially with regard to rapid technological advancements.<sup>17</sup> Additionally, to ensure that distance learning and working can be supported, the region needs an annual additional investment of \$196 billion to support ICT and climate-resilient infrastructure. Investments in Sustainable Development Goal priorities, such as health, education and infrastructure, will contribute to long-term growth, thereby increasing the Governments’ ability to service debt obligations (Lee, 2020). One advantage of such long term

<sup>16</sup> General Assembly resolution 70/1.

<sup>17</sup> Such investments enhance a country’s resilience to future shocks as well as support economic recovery. Such policies could include vocational training, assistance in the job search process, wage subsidies or public works programmes and support for micro-entrepreneurs or independent workers. Given the region’s low level of spending on active labour market policies (close to 0.19 per cent of GDP vis-à-vis an average of 0.8 per cent of GDP in Europe), this is an area with room for improvement in the near term.



investments is political as they enhance the well-being of people, which in turn influences whether politicians get elected or re-elected.<sup>18</sup>

It is obvious that, to finance such investments, Governments need to expand their fiscal space. This can be done through tax reforms, which are needed in the region due to its low tax-to-GDP ratio, reorienting available fiscal resources towards the needs of the people, developing capital markets and effectively managing public debt (the last two issues will be discussed in detail in chapter 4).<sup>19</sup>

Central banks can also contribute towards mitigating inequalities. Recent research has found some support for making inequality an explicit target for monetary policy by including a measure of inequality (for instance, a small negative weight on consumption inequality) in the Taylor rule. By doing so, a central bank can achieve higher welfare than under optimum policy (Hansen, Lin and Mano, 2020). Macroeconomic policy, including monetary policy, is already moving towards being inclusive – in August 2020, the Federal Reserve Bank of the United States of America changed its stance on this issue – it is now willing to tolerate higher inflation to help marginal sections of the labour market. Although no central bank in

the Asia-Pacific region has yet explicitly targeted inequality as a goal for monetary policy, research on SEACEN-8 economies<sup>20</sup> shows that expansionary monetary policy leads to a lower Gini index, indicating lower inequality.

### 3.2. Green policies will help address climate change

Governments need to eliminate fossil fuel subsidies in order to reduce their consumption and increase investments in renewables. Fossil fuel subsidies that amount to \$240 billion a year could be used to fund investments in renewables as well as fund a transition that is fair (given the uneven impact on jobs due to this structural shift). Additionally, Governments can help mitigate climate risks through climate-resilient infrastructure as well as carbon tax.<sup>21</sup>

Climate risks are mispriced due to either informational market failures that stem primarily from the absence of a clear, consistent and transparent globally agreed taxonomy accompanied by disclosure requirements, or the failure of market participants to correctly and fully price externalities as well as tail events that fall outside the historical distribution of outcomes (Schnabel, 2020). In this context, central banks can push towards a green economy through adoption of the following measures:

- Prudential supervision: To ensure the soundness of the banking system, stress tests need to be stepped up to include climate risks. Here, being a part of the Network of Central Banks and Supervisors for Greening the Financial System could help leverage joint work with other central banks;
- Monetary policy operations: As supervisors and regulators of the banking system, central banks can recommend the expansion of the eligibility of securities accepted by banks as collateral to support operations of those firms that disclose agreements on environmental aspects while excluding bonds that finance “brown” projects. They can adjust the so-called haircuts (discounts) to reflect climate considerations and increase targeted green lending to banks.

There is good news. Fifteen central banks in the region are members of the Network of Central Banks and Supervisors

18 For instance, research in the United Kingdom of Great Britain and Northern Ireland and the European Union shows that highly satisfied voters tend to elect incumbents. In India, ending open defecation and providing free LPG connections for more than a quarter of the electorate helped win the re-election of the incumbent party despite a slowing economy. For more information, see [www.indiatoday.in/elections/lok-sabha-2019/story/election-results-2019-5-reasons-that-got-narendra-modi-another-term-1532978-2019-05-23](http://www.indiatoday.in/elections/lok-sabha-2019/story/election-results-2019-5-reasons-that-got-narendra-modi-another-term-1532978-2019-05-23).

19 For other policies that can help Governments to increase their fiscal space, see ESCAP (2021, forthcoming), chap. 4.

20 Those economies comprise Cambodia, India, Mongolia, the Philippines, Sri Lanka, Taiwan Province of China, Thailand and Viet Nam. For more details, see [www.seacen.org/publications/RStudies/2020/RP106/Chapter\\_1-DIST\\_IMPACT.pdf](http://www.seacen.org/publications/RStudies/2020/RP106/Chapter_1-DIST_IMPACT.pdf).

21 For more details on these policies, see ESCAP (2020a).



for Greening the Financial System,<sup>22</sup> and the market for green, social and sustainability bonds, while small, is growing in the Asia-Pacific region. Outstanding bonds have grown in value from nil in 2013 to \$180 billion in 2019.<sup>23</sup> There is increasing recognition that sustainable finance needs to be expanded. For instance, in a survey<sup>24</sup> conducted by SEACEN (2019 Q2) among 18 central banks and regulatory authorities in Asia and the Pacific concerning their views on and policies regarding sustainable finance, the respondents recognized that central banks are not doing enough and there is a need to step up action in this regard. Some recent encouraging examples include the launching of the Green Bond Grant Scheme to encourage the issuance of green bonds by the Monetary Authority of Singapore (March 2017); the first global issuance of a green sovereign “sukuk” (sharia compliant) bond in Indonesia (2018); and the launch of a green refinancing policy by the People’s Bank of China that allows commercial banks to use green loans/bonds as collateral for borrowing from the Bank at discounted rates, the funds of which are then lent to green businesses.

However, more can be done, in learning from the European Central Bank (ECB), to help develop the sustainable bond market and expedite the process of greening finance in the Asia-Pacific region. ECB has made sustainability-linked bonds eligible for central bank operations, a measure which provides incentives for such markets to grow. Because climate change affects all aspects of monetary policy, namely output and inflation, long-term interest rates and policy transmission, central banks should review the implications of climate change for their primary objectives (Lagarde, 2020).<sup>25</sup> It is also likely that stricter environmental regulation may spur economic recovery, as penalizing the use of carbon in production can facilitate the reallocation of resources into green sectors and turn them into growth engines (as evidence from the European Union suggests). Countries with weak environmental standards leave this growth potential untapped (Schnabel, 2020).

To expedite the march towards implementing the 2030 Agenda, both fiscal authorities and central banks need to work together to create standards for green/social/sustainable bonds and make environmental, social and governance (ESG)-supported accounting and disclosures mandatory<sup>26</sup> (ESCAP, 2020a). This sort of intervention is appropriate in the presence of market failures.<sup>27</sup> Additionally, the returns to shareholders are higher for companies that are ESG friendly. Even if chief executive officers (CEOs) do not believe in ESG and even for those companies that adhere to Friedman’s norms about the need to focus on shareholder returns, they are unable to ignore ESG as doing so would put shareholder returns at risk. Hence, this may be what is termed mildly as “enlightened self-interest”. ESG goals can be tied to CEO salaries and executive bonuses.<sup>28</sup> If an executive wants to live by the shareholder value

22 Members are the central banks of Armenia; Australia; Cambodia; China; Georgia; Hong Kong, China; Indonesia; Japan; Malaysia; New Zealand; the Philippines; the Republic of Korea; the Russian Federation; Singapore; and Thailand.

23 The countries and areas that issue such bonds are: Australia; China; Hong Kong, China; India; Japan; the Philippines; the Republic of Korea; Singapore; and Taiwan Province of China.

24 The survey may be accessed at [www.adb.org/sites/default/files/publication/575571/adb-wp1099.pdf](http://www.adb.org/sites/default/files/publication/575571/adb-wp1099.pdf).

25 ECB could be getting ready to outrightly target the “green spread” – the difference in financing conditions for low-carbon and high-carbon activities.

26 New Zealand intends to become the first country in the world to make climate risk reporting mandatory, using the framework of the Task Force on Climate-related Financial Disclosures. Prime Minister Jacinda Ardern’s administration announced the move in September 2020.

27 As mentioned by Schnabel on 18 September 2020, “In the presence of market failures, market neutrality may not be the appropriate benchmark for a central bank when the market by itself is not achieving efficient outcomes”.

28 On 14 October 2020, coffee giant Starbucks pledged by 2025 to have at least 30 per cent of its corporate-level workforce composed of people who are black, indigenous, or broadly people of colour. This is a “venti-sized goal” to use that company’s term for a large container holding 20-24 ounces of coffee. Currently, only 3.7 per cent of Starbucks’ corporate workforce is black, and only 7.4 per cent identify as Hispanic or Latino, according to the company. So to get to that goal, Starbucks added a sweetener: diversity goals will be part of executives’ bonus starting in 2021. In 2019, Chevron added the management of greenhouse gas emissions to its executives’ pay scores. However, the GHG evaluation is coupled with personnel and environmental safety goals, which together account for just 15 per cent of the composition of an executive’s bonus.

maximization principle in the 2020s, he or she would be unwise to ignore ESG – precisely because it can have a negative impact on corporate returns and the CEO's job.

### 3.3. Building forward a better future for all

Anthropologists have always known that human societies have survived and flourished because of their unique ability to cooperate, collaborate and create. At a broad level, most economists also understand that economic and social prosperity depends on the well-being of all, not just a few. Yet, the dominant mainstream economic thinking is that private interest is the primary guide for human action, whether as businesses, consumers or even Governments. Behaviours and policies informed by such thinking produce exclusion (of people) and exploitation (of the environment and natural resources) and are not conducive to building resilience.

In Ostrom (1990), the Nobel laureate stated that in reality people collaborate, organize together and show solidarity while creating common rules and values that organize communal life. People rely on society, community and family, day in and day out. The disconnect between this lived reality of a common person and the dominant (economic) ideology pursued by policymakers leads to disillusionment and helplessness.

Focusing primarily on self-interest and efficiency, rather than collaboration and resilience, instills fear that people are in a race to compete for limited resources. Indeed, most definitions of

economics revolve around “efficient allocation of scarce resources”. The answer to scarcity, together with people's presumed desire for more and more, tends to be: “keep producing more ‘stuff’”. No wonder, GDP growth is the most popular yardstick for success, preferred by economists and policymakers alike, irrespective of whether it creates well-being or harm, or whether it damages the environment. In criticizing the exponential nature of economic growth, Raworth (2017) stated that “there is one diagram in economic theory that is so dangerous that it is never actually drawn – the long-term path of GDP growth”. This is because the long-term path of exponential growth is simply unsustainable.

In blindly pursuing the objective of efficiency and GDP growth, individuals and policymakers alike become endless optimizers of self-interest. The justification for the exclusion and exploitation of others and the environment in the process is always the same – the prospect of a better future for all. Of course, this single-minded pursuit of GDP growth – the struggle to conquer scarcity (based on efficiency, private interest, unfettered markets and unchecked globalization) – has generated unprecedented wealth. The Asia-Pacific region stands out in this regard, being the driver of global economic growth. However, it must be admitted that the process has come at a steep and exponentially rising cost – widespread deprivation, escalating inequalities, plunder of the environment and even a crisis of meaning and purpose. Again, the Asia-Pacific region stands out in this regard, experiencing the sharpest increases in income inequality in the world<sup>29</sup> and contributing the most to global GHG emissions.

To move forward, the concept of a relentless pursuit of efficiency needs to be revisited. Instead of that approach, it is necessary to focus on resilience, inclusion and sustainability. A better system of interaction, cooperation and collaboration needs to be cultivated among humans and between humans and nature.

The COVID-19 pandemic is a crisis like no other. It also offers opportunities like no other. In being forced to adjust, we have seen our lives, workplaces and habits transformed in fundamental ways. We have learned that all that “stuff” is not necessary to lead a meaningful and productive personal and work life. We have seen people risking their lives for others during this pandemic, and we have observed a reduction in air pollution and GHG emissions. We have begun to understand that producing goods more efficiently will not make the world

29 For more information on this matter, see ESCAP (2018a), p. 11.

sustainable if consumption increases simultaneously (the rebound effect or Jevons paradox).<sup>30</sup> To move towards the idea of working fewer hours or spending more time in leisure – a concept Keynes (1930) talked about in his essay on “Economic possibilities for our grandchildren” 90 years ago and a feat that has not been possible so far,<sup>31</sup> there needs to be a shift in mindset away from scarcity and efficiency towards sufficiency and resilience, as we have realized during the pandemic how little one needs to survive and lead a good life.

To this end, we can (and should) revisit fundamental assumptions of economic thinking, such as self-interest and efficiency, and ask: What do I really value? Is it misguided efficiency or inherent resilience, self-interest or common interest, and the bottom line or collective well-being? Are these mutually exclusive options or can they be pursued together? It may be difficult to answer these questions conclusively, but a balanced effort is certainly needed, and possible.

The remaining chapters in the *Survey* for 2021 analyse such possibilities, and discuss the contours of policies that can help “*build forward better*” and some of the financing options to implement the needed policies. The bottom line is fairly straightforward: such policy efforts should be concerted and coordinated around the 2030 Agenda for Sustainable Development.

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30 The paradox occurs when technological progress or government policy increases the efficiency with which a resource is used (reducing the amount necessary for any one use), but the rate of consumption of that resource rises due to increasing demand.

31 The agricultural revolution revolutionized how people think about work. The concept of scarcity materialized and hard work became a virtue. Yet, beyond the urgency of mankind's current predicament, there are good reasons not to abandon these thinkers' visions of a leisured future. Taking a far longer view of human history than that typically taken by economists would reveal not only that many of ideas about work and scarcity have their roots planted firmly in the soil of the agricultural revolution but also that, for more than 95 per cent of mankind's history, people enjoyed more leisure than is currently the case.



# Chapter 2

## Macroeconomic Outlook: Uncertain Turnaround after an Unprecedented Recession

### 1. Introduction

As the pandemic began to unfold last year, the Economic and Social Survey (ESCAP, 2020a) warned that it would “significantly increase the downside risks to the region’s near-term economic outlook”. However, the subsequent spread of the pandemic and its socioeconomic impact far exceeded all expectations and rendered much of traditional economic forecasting and planning redundant.

Although Asia and the Pacific remained the most economically robust region in the world during the pandemic in 2020 and is poised to lead the global economic recovery in 2021, its bounce back from the recession has been highly uneven. Importantly, new infection waves in several parts of the region at the beginning of 2021 and lack of progress in vaccinating against COVID-19 in the majority of developing countries in the region imply that the pandemic threat will continue to be the greatest economic challenge in the near term and its accumulating long-lasting impact will cast a shadow on the path to recovery. Meanwhile, as economic activities gradually normalize worldwide, pre-pandemic development challenges, existing vulnerabilities and downward economic pressures may re-emerge.

The focus of this chapter is to take stock of the Asia-Pacific region’s economic performance in the past year, analyse near-term economic risks and uncertainties, provide perspectives on the economic outlook for 2021/22 and suggest pertinent policy recommendations.



It finds that the Asia-Pacific region's relatively quicker economic recovery was led by the strong recovery in production and merchandise exports in East and North-East Asia and parts of South-East Asia, with other subregions and economies bouncing back gradually. Effectiveness in pandemic control, pre-pandemic economic fundamentals and structural vulnerabilities, such as high exposure to tourism or informal sectors, were among the main factors affecting country-level performance in 2020. Although considerable uncertainties remain, **the economic outlook for 2021/22 is cautiously optimistic for Asia and the Pacific.** This assessment is based on the continuing economic recovery, decline in overall COVID-19 infection rates and the beginning of vaccination programmes to prevent the disease.

The **near-term risks are tilted to the downside.** This chapter highlights that the uneven roll-out of vaccines, the pandemic's disproportionate impact on the poor and vulnerable groups and developing countries' limited fiscal response to the pandemic may prolong the threat to all posed by COVID-19 and result in a "K-shaped" recovery, both across and within countries. Meanwhile, a vicious combination of increased public debt, aggressive monetary easing, excessive financial leveraging and subdued long-term productivity could jeopardize fiscal sustainability and add to the risk of future stagflation.

With regard to **policy recommendations**, the chapter places special emphasis on inclusive recovery which leaves no country and no person behind. It

argues that a focus on inclusiveness would support more synchronized vaccination against COVID-19, reduce huge potential economic and human costs, mitigate post-pandemic inequality and social unrest risks and better support recovery of aggregate demand. It also calls for policy continuity in fiscal and monetary support in order to consolidate the recovery and improve policy quality and synergies in the process for greater developmental pay-offs. In addition, it commends the region's recent progress in seeking regional alliances as a strategy to navigate post-pandemic uncertainties in global trade and value chains.

## 2. Economic performance and outlook

### 2.1. Global context – unprecedented shock and heightened uncertainties

**The global economy experienced its worst peacetime recession in nine decades.** With four fifths of economies worldwide in a recession, global output is estimated to have contracted by 3.8 per cent in 2020, a deceleration of 6.3 percentage points compared with the 2.5 per cent economic growth rate observed in 2019.<sup>1</sup>

**An unprecedented fiscal response, however, helped to stabilize the global economy.** Global fiscal response, estimated to be about \$14 trillion<sup>2</sup> or 16 per cent of 2019 global GDP, represented the largest fiscal stimulus since the Second World War. This response was exceptionally swift and forceful, with a focus on preserving people's livelihoods, jobs and business continuity and was much larger than the entire economic stimulus package during the 2008/09 global financial crisis (Cassim and others, 2020).

**Highly accommodative monetary policies complemented the fiscal response, keeping global liquidity abundant and borrowing costs low.** Major developed economies have maintained interest rates at historical lows and shifted to more flexible monetary regimes, such as "average inflation targeting" by the United States (Powell, 2020). The use of unconventional measures, in particular quantitative easing, significantly expanded liquidity and further reduced long-term borrowing costs, especially for Governments. Developing countries also leveraged monetary measures aggressively, mostly through policy rate cuts, reduction in bank reserve

<sup>1</sup> The estimate is informed by IMF (2021b) and United Nations (2021).

<sup>2</sup> As of 31 December 2020 (IMF 2021a).



requirements, reduced or postponed repayment of interest and capital and targeted liquidity support for eligible households and businesses. These policies calmed markets and mitigated the risk of a financial meltdown (BIS, 2020).

**However, the level of fiscal stimulus is highly uneven across countries, risking further economic polarization in post-pandemic economic recovery.** Developed countries accounted for some 80 per cent of the global fiscal stimulus package in response to the COVID-19 pandemic, although representing only some 13 per cent of the global population and slightly more than half of global economic output. In contrast, developing countries on average were able to put together only 4.1 per cent of their GDP as fiscal response, a level three quarters lower than the global average, despite their much greater vulnerabilities and exposure to the COVID-19 shock. Their further squeezed fiscal space also raises concerns over the sustainability of necessary public expenditures to support post-pandemic recovery, especially when global debt relief efforts remain limited and inadequate (Lee, 2020; Munevar, 2020). Prolonged economic stagnation in developing countries will further set back cross-country income convergence and progress towards a more inclusive world (as such shocks always do).<sup>3</sup>

### Global outlook and risks

**The global economic outlook for 2021 and 2022 is cautiously positive, thanks to improvements in pandemic control and vaccine roll-out.**<sup>4</sup> Global economic growth in 2021 is expected to be 4.5 per cent, as vaccinations reduce the threat of COVID-19, and countries worldwide concentrate on rebuilding their economies to compensate for the output loss during the pandemic. Economic growth is expected to moderate to 3.7 per cent in 2022, when post-pandemic recovery consolidates and countries start to gradually withdraw extraordinary stimulus measures, enabling growth rates to converge towards their sustainable long-term path.

**However, risks are tilted to the downside, with potential divergence in the recovery path across countries.** While the earlier prognosis was that a vaccine would help reduce uncertainties related to repeated lockdowns, the concern now has shifted to the amount of time it would take to vaccinate a significant portion of the global population, as well as the

emergence of new COVID-19 variants. Furthermore, most developing countries risk being marginalized in the vaccination process, given their lack of domestic vaccine development and production capacity and lack of funding for vaccine procurement. This, coupled with their limited fiscal space to support strong post-pandemic recovery, means that a divergence in recovery paths between the developed and the developing world is highly likely, unless the global community undertakes ambitious efforts urgently to ensure a more inclusive global recovery. Additionally, repeated economic disruptions, productivity deterioration and weak growth performance from lockdowns in response to rising cases of COVID-19 could exacerbate the risks associated with high and rising debt, resulting in fiscal unsustainability and financial instability.

**Although subdued global demand has kept inflation low, inflationary pressures may re-emerge as the global economy recovers.** Faster-than-expected roll-out of COVID-19 vaccines could unleash the pent-up private demand, driving up core inflation. A synchronized round of opening up around the globe may also push up commodity prices and headline inflation when resources are poured into rebuilding economies. Meanwhile, sudden changes in cross-border financial flows, high financial leveraging and dangerous capital market overheating may oblige Governments to reconsider their policy positions and switch to more selective fiscal and monetary support, even before inflationary pressures materialize.

<sup>3</sup> See chapter 3.

<sup>4</sup> The global outlook is informed by IMF (2021b) and United Nations (2021).

## 2.2. Asia-Pacific developing countries – battered but not broken

**Long-term economic growth momentum has been disrupted, with increasing risk of divergence in economic performance across countries**

**The economic performance of Asia-Pacific developing countries in 2020 was at its worst in recent history.**

The pandemic accelerated and exacerbated the downward pressure on several economies in the region, which had been slowing for two consecutive years in 2018 and 2019. The combined GDP of Asia-Pacific developing countries is estimated to have contracted by 1.0 per cent in 2020, a 5.2 percentage point deceleration from the already weak growth performance of 4.2 per cent in 2019.

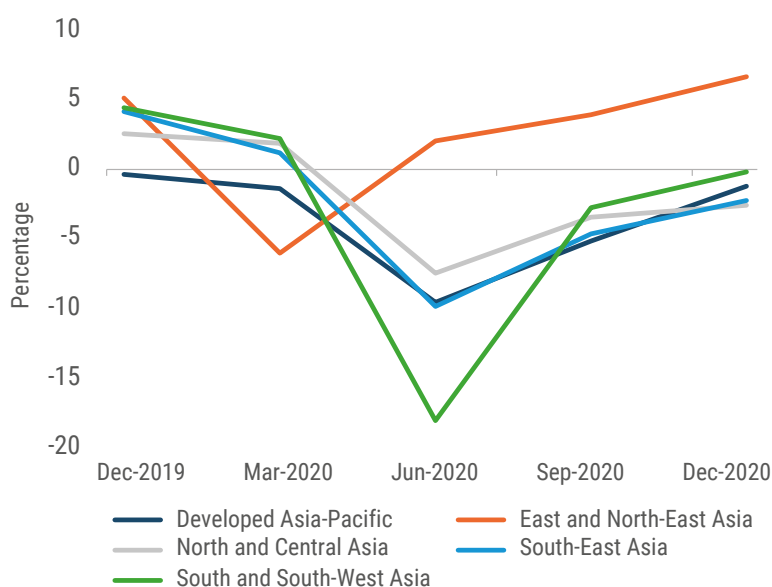
**The economic contraction in 2020 was broad-based, but with significant variation across countries.**

Economic growth slowed in all Asia-Pacific economies, with three fourths of them experiencing a recession in 2020. Although the worst shocks proved short-lived, and most Asia-Pacific developing countries had entered the recovery phase by the third quarter of 2020, the pandemic's economic impact and the speed of recovery have been highly uneven both across and within subregions (figure 2.1).

Multiple factors contributed to such differences. For instance, swift and effective pandemic control supported strong production recovery and export expansion in China and Viet Nam. Bangladesh benefited from its robust economic fundamentals and prudent fiscal management prior to the pandemic as well as a countercyclical surge in remittance inflows. The high gold price and low oil price helped Tajikistan, which is a gold exporter and fossil fuel importer. Economic structure may have also conferred benefits on countries with a large agricultural sector, which suffered less disruption. In contrast, countries experiencing longer outbreaks of COVID-19 and lockdowns, with larger contact-intensive and informal sectors, and that were more dependent on international tourism, are among the worst affected and slowest to recover.

**Figure 2.1**

**Economic growth year on year, by subregional grouping**



Source: ESCAP based on CEIC data. Accessed on 9 March 2021.

**Box 2.1****Country and subregional highlights**

**China and India:** China's swift and effective response to COVID-19 enabled it to become the only major economy worldwide to achieve a positive annual economic growth rate in 2020. Supported by strong recovery in industrial production, infrastructure and housing investment, merchandise exports, and a modest recovery in private consumption, its 6.5 per cent year-on-year growth rate in the fourth quarter exceeded pre-pandemic growth levels. The recovery is expected to further consolidate in 2021, although there is growing concern over high financial leveraging pointing towards more cautious and targeted stimulus policies in 2021. India entered the pandemic with subdued GDP growth and investment. Following one of the most stringent lockdowns in the world, the economic disruptions that the country experienced mounted in the second quarter of 2020. A subsequent change in lockdown policies and success in reducing infection rates supported an impressive economic turnaround in the third quarter. However, the pace of recovery moderated in the fourth quarter with estimated year-on-year growth still close to zero. Despite a robust reduction in new COVID-19 cases and the start of vaccine roll-out, India's 2021 economic output is expected to remain below the 2019 level. Meanwhile, maintaining low borrowing costs while keeping non-performing loans in check would be a challenge.

**Least developed countries:** The economic output of this group of countries as a whole expanded by 3.0 per cent in 2020. Three main factors contributed to this positive growth: the 5.2 per cent economic growth in fiscal year 2019/20 in Bangladesh, the group's largest economy; a larger rural sector, which suffered less adverse impacts from the pandemic; and weaker trade linkages with other countries, which partly insulated them from the COVID-19 shock. However, the group still experienced a sizable economic deceleration compared with 2019's 7.2 per cent growth rate; due to their greater employment pressures and lower income levels, their citizens' livelihoods could be more sensitive to growth fluctuations. The thin fiscal buffers and inadequate social security support may further amplify the negative shocks and suffering, and delay the post-pandemic recovery (ESCAP, forthcoming).

**Developing East and North-East Asian economies:** The relatively more effective response to the COVID-19 pandemic, strong recovery in semiconductor exports and effective policy packages contributed to the Republic of Korea's resilience during the pandemic. The moderate 0.9 per cent contraction in GDP in 2020 was the best performance among countries at a similar level of development. The recovery package, dubbed Korean New Deal, combined digital and green transformations with a primary focus on jobs, representing a sound integration of employment, economic upgrading and environmental objectives. Recovery in Mongolia, on the other hand, was hampered by new COVID-19 outbreaks in 2021, despite a quick rebound in exports. Its economy had already suffered an estimated 5.8 per cent recession in 2020, and the persistent threat of COVID-19 infections and strict lockdowns would further weigh on growth in the near term.

**South-East Asia:** The subregion's recovery was supported by its strong merchandise export performance, with a 7.0 per cent increase in bilateral trade with China during the recession. This reflects the significance of integrated regional value chains for South-East Asian economies.

However, only a few countries, such as Viet Nam, managed to fully capture this tailwind. Indonesia, Malaysia and the Philippines remained mired in prolonged pandemic threats and economic disruptions. Malaysia, for instance, reimposed nationwide restrictions on 19 January 2021 in the light of new waves of infection. Structural vulnerabilities, such as high economic informality (Cambodia, Indonesia, Lao People's Democratic Republic and Myanmar), reliance on remittances (Philippines) and dependence on international tourism (Cambodia and Thailand), also exacerbated economic impacts of the pandemic and hampered recovery. Meanwhile, political instability may cast additional shadows over the near-term economic outlook in some economies in the subregion, especially in Myanmar, which may face the risk of economic sanctions.

**South and South-West Asia:** High population density, inadequate health and sanitation services, high economic informality and great exposure to low-skill, contact-intensive sectors made the COVID-19 crisis more damaging in this subregion (ESCAP, 2020b). In addition, the high dependence on international tourism in Bhutan, Maldives, Nepal and Sri Lanka further aggravated and prolonged the economic suffering. Pakistan was caught at its most vulnerable moment, with weak economic fundamentals and ongoing fiscal consolidation. The two other major economies in the subregion, the Islamic Republic of Iran and Turkey, also experienced multiple challenges during the pandemic, including geopolitical tensions, high inflation and financial instability. The Islamic Republic of Iran, in particular, was already in deep recession due to economic sanctions when the dual shock of COVID-19 and the oil price crash occurred. Its 9.6 per cent recession in 2020 was one of the deepest among the large economies in the region.

**North and Central Asia:** The subregion's overdependence on commodity exports and remittances increased the downward economic pressure when the oil price crashed in early 2020. This resulted in temporary but sizeable public revenue losses in Azerbaijan, Kazakhstan and the Russian Federation (ESCAP, 2021b). The continuing COVID-19 outbreak in the Russian Federation also affected remittance flows into Kyrgyzstan, Tajikistan and Uzbekistan, which account for 33, 29 and 15 per cent of GDP in these three countries respectively. The combined effect of economic deceleration and fall in revenue put depreciation pressures on currencies in a number of the subregion's economies, also triggering imported inflation pressure. Political upheaval in Kyrgyzstan and armed conflict between Armenia and Azerbaijan exerted further drags on their economic performance, while the significant drop in tourist arrivals continues to weigh on Georgia's economy. In 2021, further recovery in oil prices and global demand is expected to support modest economic growth in the subregion.

**Pacific island developing States:** The COVID-19 pandemic further exacerbated the unique development challenges, in particular the frequent and high-intensity natural disasters and ongoing climate change threat, that confront the subregion and have devastated local economies. The subregion was affected by a number of cyclones, with significant economic losses and damage in 2020, while the pandemic severely affected the two vital economic lifelines of local economies: tourism and fisheries (Tateno and Bolesta, 2020). The subregion also experienced a decline in commodity exports, remittances and foreign direct investment, all of which are their important external sources of finance (Claus, forthcoming). Such compounded shocks resulted in double-digit or close-to-double-digit economic recessions in Fiji, Palau, Samoa and Vanuatu in 2020 (table 2.1).

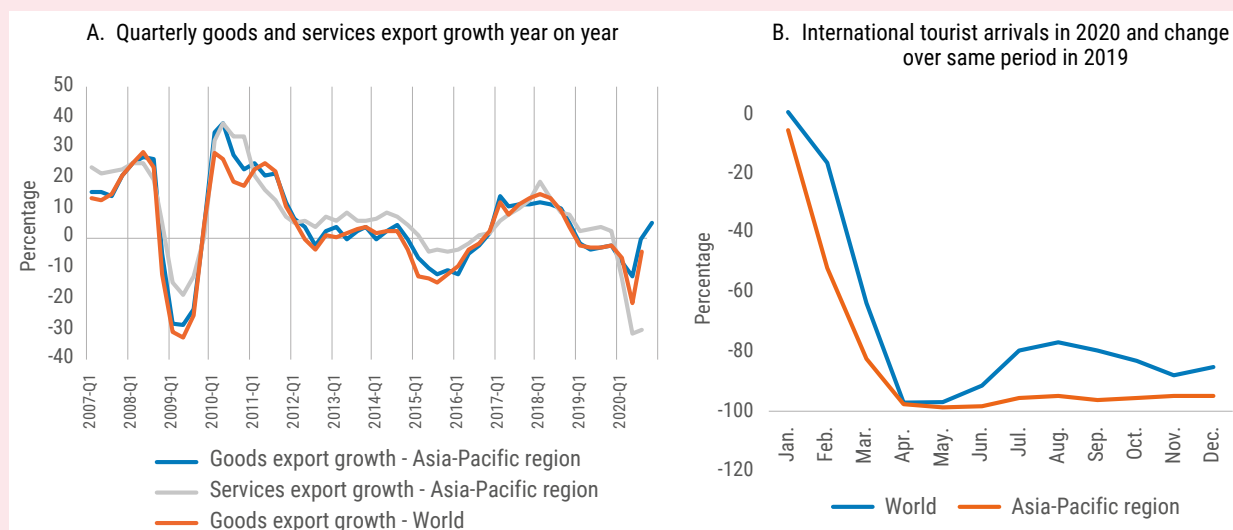
## Box 2.2

### Trade and regional value chains

Merchandise exports and regional value chains demonstrated strong resilience during the pandemic, despite initial doubts over their robustness. The Asia-Pacific region's merchandise exports consistently outperformed the global trend in 2020 and quickly rebounded to pre-pandemic levels in the third and fourth quarters (figure A). Developing countries in East and North-East Asia and parts of South-East Asia, in particular, managed to fill the supply vacuum and meet surges in global demand for electronics, pharmaceuticals and personal protective equipment during the pandemic.

However, global services trade, which had demonstrated greater resilience in previous economic decelerations, suffered a much greater impact and has yet to recover. This is mainly due to the devastating blow delivered by the pandemic with regard to international travel and tourism (figure B); a recovery in this sector remains out of sight.

### Figure



Source: Panel A. ESCAP calculations, based on World Trade Organization data. Accessed on 9 March 2021.

Panel B. ESCAP calculations, based on World Tourism Organization data. Accessed on 24 February 2021.

**Table 2.1**
**Selected economies in the ESCAP region: rates of economic growth and inflation, 2019-2022**

(Percentage)	Real GDP growth				Inflation <sup>a</sup>			
	2019	2020 <sup>b</sup>	2021 <sup>c</sup>	2022 <sup>c</sup>	2019	2020 <sup>b</sup>	2021 <sup>c</sup>	2022 <sup>c</sup>
<b>Total ESCAP region</b>	<b>3.3</b>	<b>-1.8</b>	<b>5.2</b>	<b>4.3</b>	<b>3.6</b>	<b>3.2</b>	<b>3.0</b>	<b>3.1</b>
<b>Developing ESCAP economies<sup>d</sup></b>	<b>4.2</b>	<b>-1.0</b>	<b>5.9</b>	<b>5.0</b>	<b>4.6</b>	<b>4.2</b>	<b>3.8</b>	<b>3.8</b>
<b>Developed ESCAP economies<sup>e</sup></b>	<b>0.6</b>	<b>-4.4</b>	<b>3.2</b>	<b>2.1</b>	<b>0.7</b>	<b>0.2</b>	<b>0.5</b>	<b>1.1</b>
<b>East and North-East Asia<sup>f</sup></b>	<b>3.7</b>	<b>-0.5</b>	<b>5.5</b>	<b>4.2</b>	<b>1.9</b>	<b>1.5</b>	<b>1.1</b>	<b>1.8</b>
<b>East and North-East Asia (excluding Japan)<sup>f</sup></b>	<b>5.4</b>	<b>1.6</b>	<b>6.8</b>	<b>5.4</b>	<b>2.6</b>	<b>2.2</b>	<b>1.5</b>	<b>2.1</b>
China	6.0	2.3	7.2	5.8	2.9	2.5	1.6	2.3
Democratic People's Republic of Korea	..	..	..	..	..	..	..	..
Hong Kong, China	-1.3	-6.1	4.2	2.2	2.9	0.3	1.0	1.5
Japan	0.3	-4.8	3.0	1.8	0.5	0.0	0.2	1.0
Macao, China	-2.6	-58.3	43.5	35.5	2.8	0.8	1.0	2.3
Mongolia	5.6	-5.8	5.2	5.6	7.3	3.7	6.0	6.2
Republic of Korea	2.0	-0.9	3.0	2.2	0.4	0.5	1.0	1.0
<b>North and Central Asia<sup>f</sup></b>	<b>1.9</b>	<b>-2.9</b>	<b>2.9</b>	<b>2.6</b>	<b>4.9</b>	<b>4.3</b>	<b>4.6</b>	<b>4.5</b>
<b>North and Central Asia (excluding Russian Federation)<sup>f</sup></b>	<b>4.5</b>	<b>-2.2</b>	<b>3.5</b>	<b>4.0</b>	<b>6.4</b>	<b>7.7</b>	<b>7.0</b>	<b>6.4</b>
Armenia	7.6	-6.9	3.5	4.0	1.5	1.2	4.0	4.0
Azerbaijan	2.2	-4.3	2.0	2.5	2.7	2.8	3.2	3.5
Georgia	5.1	-5.2	4.2	4.0	4.9	5.2	3.9	4.1
Kazakhstan	4.5	-2.8	3.0	4.0	5.2	6.8	5.8	5.2
Kyrgyzstan	4.6	-8.0	4.1	4.5	1.1	6.3	5.3	2.8
Russian Federation	1.3	-3.1	2.8	2.3	4.5	3.4	4.0	4.0
Tajikistan	7.5	4.2	5.0	4.0	7.8	8.6	8.7	8.0
Turkmenistan	3.0	-1.1	3.1	2.5	5.1	12.1	8.3	8.2
Uzbekistan	5.8	1.6	5.6	6.0	14.6	12.9	13.5	11.5
<b>Pacific<sup>f</sup></b>	<b>2.1</b>	<b>-2.6</b>	<b>4.0</b>	<b>3.5</b>	<b>1.6</b>	<b>1.0</b>	<b>1.5</b>	<b>1.5</b>
<b>Pacific island developing economies<sup>f</sup></b>	<b>4.4</b>	<b>-6.4</b>	<b>2.8</b>	<b>4.1</b>	<b>3.0</b>	<b>2.8</b>	<b>2.8</b>	<b>4.2</b>
Cook Islands	6.0	-7.0	-12.0	-5.0	0.0	0.7	1.5	1.5
Fiji	-0.4	-19.0	2.6	5.2	1.8	1.5	0.8	2.0
Kiribati	2.4	0.6	1.8	1.9	-1.8	1.0	1.1	1.5
Marshall Islands	5.3	-5.5	-1.0	1.8	0.1	0.3	0.5	1.5
Micronesia (Federated States of)	1.2	-5.4	-1.8	0.6	-1.0	1.6	1.9	2.0
Nauru	1.0	0.7	0.5	0.9	4.3	0.9	1.2	2.0
Palau	0.3	-9.6	-8.0	2.0	0.6	0.4	0.8	1.0
Papua New Guinea	5.9	-3.8	3.5	4.2	3.6	3.3	3.4	5.0
Samoa	2.3	-10.1	-8.0	2.8	1.1	-1.7	0.3	2.2
Solomon Islands	1.2	-5.6	3.4	3.0	1.6	4.0	3.0	3.3
Tuvalu	6.3	0.8	3.1	3.6	3.3	3.0	3.0	2.2
Vanuatu	2.8	-9.8	3.9	3.9	2.8	3.0	2.4	2.5



(Percentage)	Real GDP growth				Inflation <sup>a</sup>			
	2019	2020 <sup>b</sup>	2021 <sup>c</sup>	2022 <sup>c</sup>	2019	2020 <sup>b</sup>	2021 <sup>c</sup>	2022 <sup>c</sup>
<b>Developed countries in the Pacific subregion<sup>f</sup></b>	<b>2.0</b>	<b>-2.5</b>	<b>4.0</b>	<b>3.5</b>	<b>1.6</b>	<b>1.0</b>	<b>1.5</b>	<b>1.5</b>
Australia	1.9	-2.6	4.0	3.5	1.6	0.9	1.5	1.5
New Zealand	3.0	-1.6	4.0	3.2	1.6	1.7	1.4	1.2
<b>South and South-West Asia<sup>g</sup></b>	<b>2.3</b>	<b>-4.7</b>	<b>5.6</b>	<b>5.3</b>	<b>10.7</b>	<b>10.6</b>	<b>10.0</b>	<b>8.3</b>
Afghanistan	3.0	-3.8	4.4	4.5	2.3	5.6	4.7	5.1
Bangladesh	8.2	5.2	7.2	8.0	5.5	5.6	5.9	5.6
Bhutan	5.3	0.4	3.5	5.2	2.7	6.0	4.6	4.3
India	4.2	-7.7	7.0	6.5	4.8	5.9	4.6	5.0
Iran (Islamic Republic of)	-6.5	-9.6	4.6	3.1	36.2	35.0	38.0	25.0
Maldives	5.9	-20.4	9.9	10.5	0.2	-1.4	1.0	1.5
Nepal	7.0	2.3	0.6	2.6	4.5	6.3	4.0	4.5
Pakistan	1.9	-0.4	1.5	2.0	6.8	10.8	8.0	6.5
Sri Lanka	2.3	-5.2	4.3	4.5	3.5	6.2	4.6	5.1
Turkey	0.8	1.6	3.8	4.0	15.5	12.3	12.0	10.0
<b>South-East Asia<sup>f</sup></b>	<b>4.4</b>	<b>-3.9</b>	<b>4.7</b>	<b>4.7</b>	<b>2.1</b>	<b>1.2</b>	<b>2.4</b>	<b>2.6</b>
Brunei Darussalam	3.9	1.2	2.6	3.0	-0.4	1.9	1.0	1.0
Cambodia	7.1	-1.4	4.8	5.5	1.9	2.9	3.0	3.1
Indonesia	5.0	-2.1	5.0	5.2	2.8	2.0	3.0	3.2
Lao People's Democratic Republic	4.7	-0.6	4.9	4.8	3.3	5.1	4.1	3.3
Malaysia	4.3	-5.6	4.0	4.2	0.7	-1.1	2.0	2.3
Myanmar	6.9	1.8	2.0	2.0	8.8	3.9	5.2	6.0
Philippines	6.0	-9.3	6.5	6.0	2.5	2.6	2.9	3.1
Singapore	1.3	-5.4	4.0	3.0	0.6	-0.2	1.5	1.2
Thailand	2.3	-6.1	3.5	4.0	0.7	-0.8	0.9	1.1
Timor-Leste	3.1	-6.8	4.0	4.8	0.9	0.9	2.0	2.5
Viet Nam	7.0	2.8	7.0	6.8	2.8	3.2	2.4	3.5
<b>Memorandum items:</b>								
<b>Least developed countries</b>	<b>7.2</b>	<b>3.0</b>	<b>5.1</b>	<b>5.7</b>	<b>5.7</b>	<b>5.1</b>	<b>5.3</b>	<b>5.4</b>
<b>Landlocked developing countries</b>	<b>4.5</b>	<b>-2.0</b>	<b>3.4</b>	<b>4.0</b>	<b>6.1</b>	<b>7.5</b>	<b>6.8</b>	<b>6.2</b>
<b>Small island developing States</b>	<b>4.5</b>	<b>-8.1</b>	<b>3.7</b>	<b>4.9</b>	<b>2.6</b>	<b>2.2</b>	<b>2.5</b>	<b>3.8</b>

a Changes in the consumer price index.

b Estimates as of 9 March 2021.

c Forecasts as of 9 March 2021.

d Developing ESCAP economies consist of all countries and areas listed in the table, excluding Australia, Japan and New Zealand.

e Developed ESCAP economies consists of Australia, Japan and New Zealand.

f Aggregate growth rate calculated using 2018 GDP in 2010 United States dollars as weights.

g The estimates and forecasts for the following countries in this subregion relate to the 2020 fiscal year, spanning periods as below:

1 April 2020 to 31 March 2021 in India;

21 March 2020 to 20 March 2021 in Afghanistan and the Islamic Republic of Iran;

1 July 2019 to 30 June 2020 in Bangladesh, Bhutan and Pakistan;

16 July 2019 to 15 July 2020 in Nepal.

## The pandemic leaves deep and long-lasting scars on employment, poverty, labour productivity and inequality

**Employment was strongly affected during the pandemic.** In Asia and the Pacific, total working hours are estimated to have shrunk by 6.5, 16.9, 5.4 and 2.8 per cent, respectively, in the four quarters of 2020, equivalent to an average loss of 140 million full-time jobs over the whole year (figure 2.2A).

**The pandemic also erased years of progress in poverty reduction.** An additional 89 million people<sup>5</sup> in the region are estimated to have

<sup>5</sup> This estimation of “income poverty” is informed by Caruso and others (2017). Please see annex I for detailed methodological notes and a comparison on different existing estimates of the impact of the COVID-19 pandemic impact on income poverty. The Asia and the Pacific SDG Progress Report (ESCAP, 2021a) also estimated the pandemic’s impact on “multidimensional poverty”. According to this much broader definition, the poverty increase was 636 million people across the Asia-Pacific region.

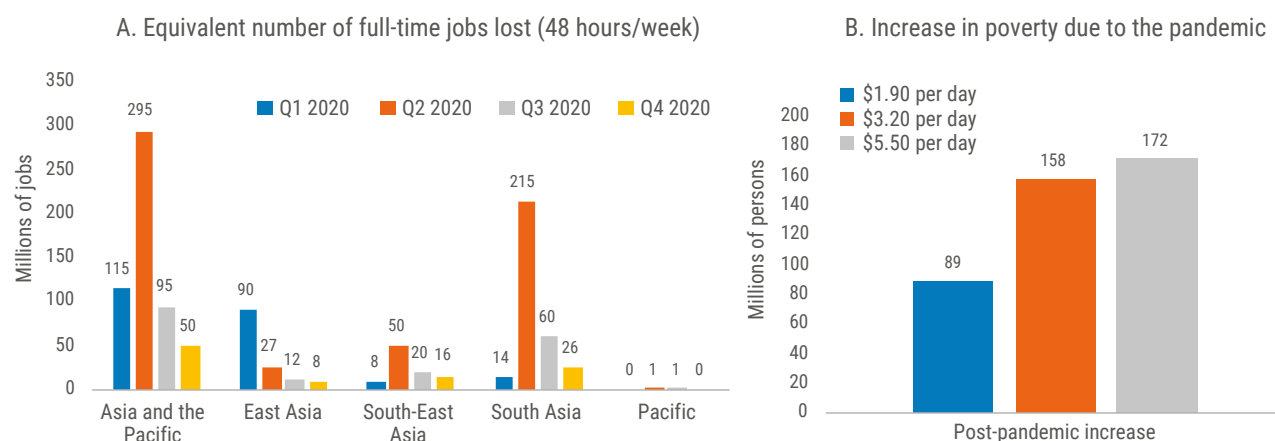
been pushed back into extreme poverty, according to the \$1.90 per day threshold. If higher income criteria, such \$3.20 or \$5.50 per day, are considered, the total number of poor would more than double (figure 2.2B). The South and South-West Asian subregion accounts for more than 80 per cent of this increase in poverty, as this densely populated subregion is among the worst affected.

**Low-skilled, low-income workers, who are concentrated in contact-intensive traditional service sectors and labour-intensive manufacturing, were disproportionately affected by the pandemic.** Rural-urban and cross-border migrant workers, in particular, were confronted with the dual challenge of losing their jobs while not being able to return home when transportation was no longer available or affordable. The vulnerability of informal employment was further exposed, not only because of job insecurity but also because informal workers often lacked access to the limited public support available during the pandemic. Among them, women and the youth were the most disadvantaged (Jurzyk and others, 2020), especially when the competition for the few remaining jobs intensified.

**Low-skilled, low-income workers were further marginalized in their adaptation to new job requirements.** For instance, in low-income countries, of every 26 jobs only 1 can be done from home, compared with the global average of 1 in

**Figure 2.2**

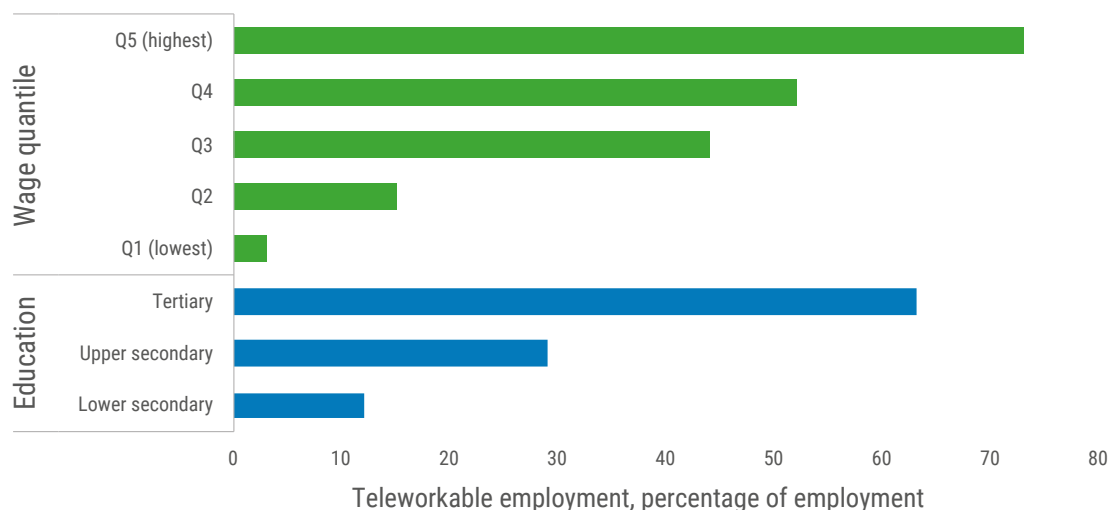
### Total working hours lost and increase in poverty



Source: Panel A. ESCAP, based on ILO (2021); and Panel B. ESCAP estimation based on World Bank data. Accessed on 2 March 2021.

**Figure 2.3**

### Inequality in teleworking opportunities



Source: Calculations by Sostero and others (2020), based upon EU Labour Force Survey and Structure of Earnings Survey.

5 jobs (Garrote Sanchez and others, 2020).<sup>6</sup> Those with less education and working in the informal or low-skill sectors may find it more difficult to find teleworking jobs, as has occurred even in the European Union where the digital divide is significantly narrower than in developing countries (figure 2.3).<sup>7</sup> Such inequality in opportunities and the prospect of a continuing transition towards teleworking even after the pandemic imply further widening in income gaps and a reduction in long-term social mobility. Worse, persistent unemployment or partial employment can result in skill losses, adding to the long-term scars on labour productivity and economic inequality.<sup>8</sup>

**Massive education disruptions will have a long-lasting impact on human capital formation and economic inequality as well.** A total of 1.6 billion learners in more than 190 countries worldwide were estimated to have been affected by school closures (UNSDG, 2020). While innovations in distance learning provided quick responses to this challenge, the digital divide's negative impact on education equality multiplied in the process. For example, in 12 Asia-Pacific developing countries, less than 30 per cent of the population have access to the Internet. Even with accessibility, the reliability, quality and affordability of Internet connections, as

well as the affordability of necessary electronic devices for distance learning, will remain significant obstacles for the poor to overcome. Without effective and inclusive distance learning solutions, the existing level of education inequality would surely be further amplified, with long-term implications for human capital and economic inequality.

**The pandemic's lasting impact on economic inequality could also come from the capital market boom fuelled by the massive injection of financial liquidity.** The wealth-amplifying effect would disproportionately benefit the rich who possess greater wealth for investment and tend to hold a larger proportion of their wealth in financial assets.

These multidimensional impacts are often not directly captured by GDP, which is primarily a limited measure of economic activity rather than a comprehensive measure of overall economic wellbeing (Box 2.3).

<sup>6</sup> For additional discussion on teleworking constraints in developing countries, see Gottlieb and others (2020).

<sup>7</sup> For additional discussion on the uneven opportunities of teleworking, see ILO (2020).

<sup>8</sup> For details on the literature cited, see Cerra, Fatas and Saxena (2020).

### Box 2.3

#### Limitations of GDP as a yardstick for economic development

The limitations of GDP, from a measurement perspective, are well known and well documented. In a nutshell, there are two broad issues. First, GDP is simply a (limited) measure of economic activity and does not capture well-being/overall societal progress, including its distribution. Second, GDP does not address environmental issues and ecological boundaries.

Depending on the level of ambition, three approaches can be used to address these concerns.

1. **Adjusting GDP**; that is, finding solutions within the current system of national accounts. For instance, putting more emphasis on households and related indicators and integrating distributional information;
2. **Complementing GDP**; that is, going beyond the system of national accounts. Examples could include: estimating unpaid household activities; incorporating monetized environmental and social factors; and implementing System of Environmental-Economic Accounting (SEEA);
3. **Replacing GDP**; that is, measuring (sustainable) well-being using a dashboard of indicators. Two well-known examples of this approach are: (a) the UNDP Human Development Index (HDI). It not only extends the dimensionality – simultaneous focus on GDP per capita, education and life expectancy – but also attempts to capture the diminishing importance of income with increasing GDP; and (b) the OECD Better Life Index, supplemented by an underlying framework of accounts.

Asia-Pacific countries have started to broaden their evaluation of economic development with more comprehensive and balanced measurements. For instance, 14 countries in the region indicated that they had an environmental-economic accounting programme as of end-2017. An additional nine countries announced that they plan to implement the SEEA system. Publishing timely, standardized and universally recognized statistics would be key for this purpose.

#### Immediate policy responses to the COVID-19 pandemic, while unprecedented, remain inadequate

*Fiscal policy was dictated by means rather than needs*

ESCAP estimates that Asia-Pacific developing countries deployed more than \$1.8 trillion, equivalent to 6.6 per cent of their combined 2019 GDP, between February 2020 and the end of January 2021, in fiscal response to the COVID-19 crisis. Additional budgetary spending and foregone revenues accounted

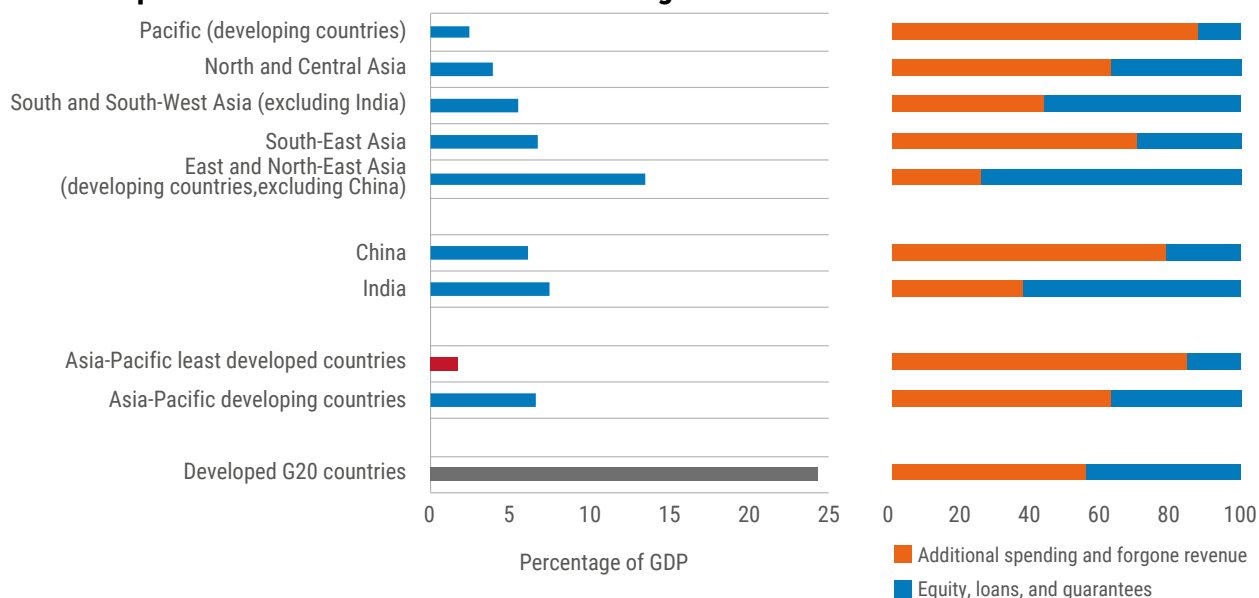
for about 63 per cent of this total amount; the rest went for liquidity support for firms and households. Although for many Asia-Pacific developing countries such fiscal stimulus was unprecedented, its scale as a share of GDP was only a fraction of the amount deployed by G20 developed countries (figure 2.4).

**Fiscal response was particularly small<sup>9</sup> in developing economies in the Pacific and in the Asia-Pacific region's least developed countries** (figure 2.4). Within these groups, a wide range of spending levels exist, with some countries, such as Bhutan, Kiribati, Nauru and Tuvalu, spending more than 10 per cent of GDP. However, for some of the larger economies among them, such as Cambodia, Lao People's Democratic Republic, Papua New Guinea and Solomon

<sup>9</sup> Weighted average based on 2019 GDP size.

**Figure 2.4**

**Fiscal response to COVID-19 in the Asia-Pacific region**



Source: Lee (2020), updated on 24 February 2021.

Islands, their fiscal response to the COVID-19 pandemic was just about 1 per cent of GDP or less. The South and South-West Asian subregion also managed to spend only 7.0 per cent of GDP to support households and businesses, even though the subregion experienced the worst setbacks in poverty reduction and jobs worldwide.

**There was a clear disconnect between the need for fiscal support to safeguard people's livelihoods and development progress and the actual amount spent** (Lee, 2020). Fiscal responses were constrained by policy space, with a strong correlation with sovereign credit ratings and, to a lesser extent, with sovereign bond spreads and public debt-to-GDP ratios.

*Monetary policy compensated to some extent for the limited fiscal response, including through the use of unconventional measures*

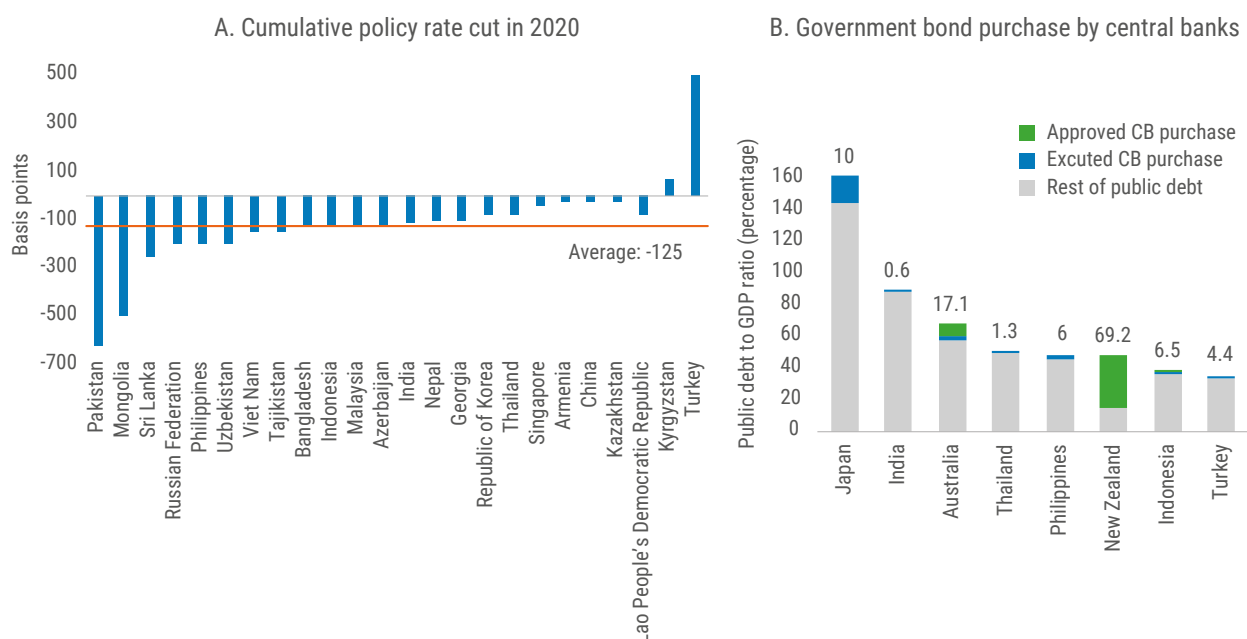
**Accommodative monetary and liquidity support measures were broadly adopted by Asia-Pacific developing countries, partly to compensate for their limited fiscal responses.** Most countries cut policy rates in 2020, with several making aggressive cuts (figure 2.5A). Most notably, Pakistan brought down the policy interest rate by 625 basis points to 7.0 per cent, as inflation expectations remained largely stable due

to subdued demand. Countries also chose from a wide range of other measures to expand liquidity access and reduce financial burdens and borrowing costs, including relaxed regulatory restrictions and bank reserve requirements, suspension of interest or principal repayment, preferential loans to targeted businesses or individuals, capital injection into special liquidity support vehicles. Financing of small and medium-sized enterprises (SMEs) was prioritized in this process, with 11 countries providing SMEs with direct loan support.

**Several countries also experimented with unconventional measures, with central banks assuming the role of the buyer of last resort.** The central banks of India, Indonesia, the Philippines, Thailand and Turkey launched asset purchase programmes for the first time, including direct public debt financing in the case of

**Figure 2.5**

## Conventional and unconventional monetary easing measures



Source: ESCAP, based on CEIC data and IMF.

Note: CB = central bank.

Indonesia. Although the scale of these programmes remains limited (figure 2.5B) compared with quantitative easing in the developed world, such unprecedented moves imply a shift in monetary policy thinking among these developing countries under unusual circumstances (Arslan and others, 2020).

### 2.3. Outlook for Asia-Pacific developing countries – hope for the best, prepare for the worst

**Stronger-than-expected economic recovery in the third and fourth quarters of 2020, continuing improvements in pandemic control, and the beginning of COVID-19 vaccination programmes support a**

### cautiously optimistic economic outlook for 2021 and 2022.

Recessions triggered by economic or financial malfunctioning normally take longer to heal, as the underlying economic weaknesses need to be addressed first. In contrast, the COVID-19 crisis is primarily a non-economic shock and, unlike natural disasters, has not resulted in massive destruction of physical infrastructure or productive capital. Therefore, swift economic recovery is possible, but on the important condition that the pandemic threat can be effectively contained and eventually eliminated.

### Asia-Pacific developing economies as a whole are expected to grow by 5.9 per cent in 2021 and 5.0 per cent in 2022.

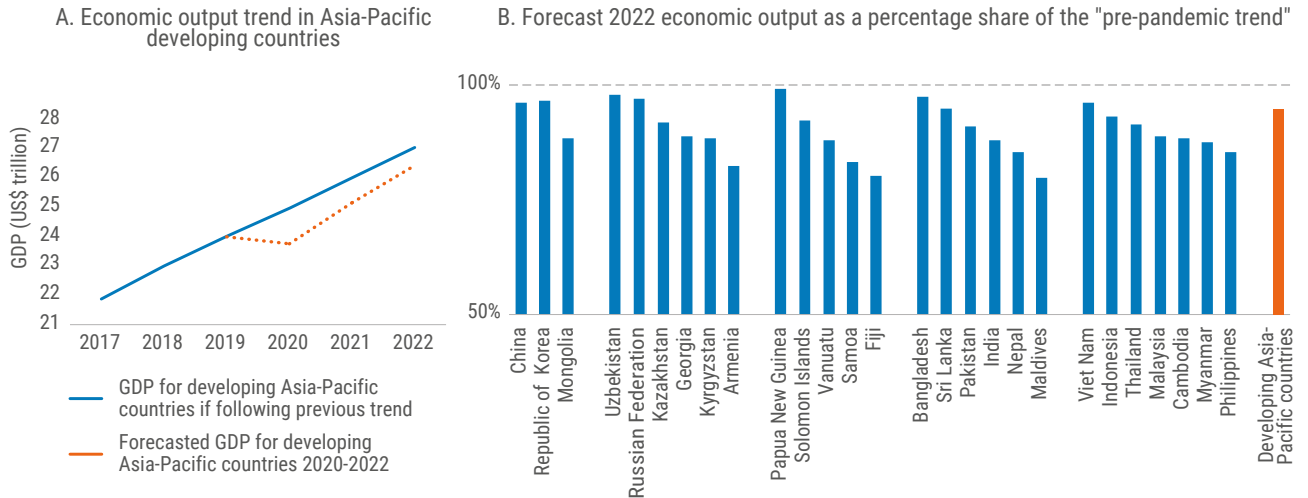
Such higher-than-usual economic growth, if materialized, could help the region to recover some of the output losses in 2020. However, they are partly driven by the small base effect of a recession year and will not be enough to put the region back on the level of its pre-pandemic trend.<sup>10</sup> ESCAP estimates suggest that by 2022 GDP in half of the Asia-Pacific developing countries would still be more than 10 per

<sup>10</sup> For further discussion on post-recession recoveries, see Cerra and Saxena (2008) and Cerra, Panizza and Saxena (2013).



**Figure 2.6**

**Economic output trend before and after the pandemic, and ratio of recovery in economic output by 2022**



**Figure 2.7**

**Inflation and inflation targets in Asia and the Pacific**



Source: ESCAP, based on CEIC data. Accessed on 9 March 2021.

cent lower than the level they would have achieved in the absence of the pandemic, and the cumulative output loss over 2020-22 would be close to \$2.6 trillion (figure 2.6). Headline inflation is likely to remain at low or moderate levels (figure 2.7), given the slower recovery in consumption demand in comparison with production recovery.

**Merchandise exports are expected to remain strong, yet recovery in services trade is unlikely in the near future.** Merchandise exports in 2021/22 are expected to be supported by three factors: continuing economic recovery in the Asia-Pacific region itself; a consumption rebound in the developed world supported by vaccination campaigns; and high demand for electronics and ICT equipment driven by digitalization. Regional value chains, especially in East and South-East Asia, have demonstrated their competitiveness in stressful times, which may further solidify the region's position as the world's manufacturing hub. Meanwhile, the recent signing of the Regional Comprehensive Economic Partnership and the possibility of reduced risk in further escalation of trade tensions are also positive developments. On the other hand, the long-term trend of deceleration in global trade expansion remains unchanged. Most importantly, trade in global services, especially international tourism, is most likely to remain subdued throughout 2021, hampering the economic recovery of countries with large tourism sectors.

**Fiscal and monetary policies are likely to remain accommodative to support post-pandemic recovery.** This is driven by the necessity to

further consolidate the recovery and to hedge against heightened uncertainties, as discussed in section 3 below. However, policy space is likely to become limited, making provision of continued policy support for households and businesses more challenging, especially for countries with public debt stress or financial vulnerabilities.

### 3. Risks and uncertainties to the economic outlook

#### 3.1. COVID-19 pandemic – lingering threat and uneven vaccine roll-out

As of the end of January 2021, more than 100 million people globally had contracted COVID-19, and the disease caused more than 2 million deaths worldwide; the new infection headcount still exceeds half a million people every day. Despite significant progress in diagnosis, treatment and prevention approaches and some success in flattening the infection curve, a robust reversal has yet to be achieved due to implementation difficulties and often premature lifting of containment measures.

**In Asia and the Pacific, the COVID-19 outbreak is still far from being decisively contained** (figure 2.8). Daily new cases remain in the thousands in major South and South-West Asian and North and Central Asian countries. The outbreak also continues in Indonesia, with new hotspots emerging in South-East Asia and East and North-East Asia.

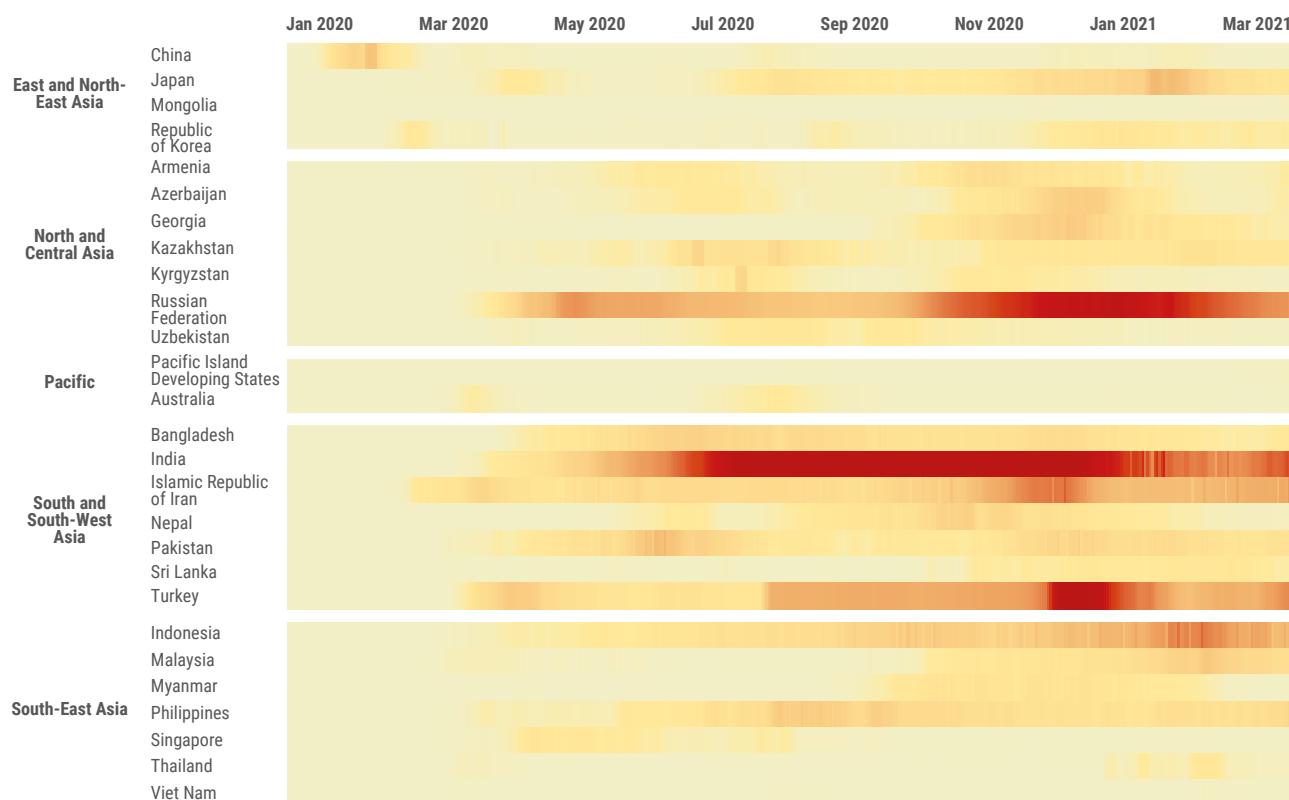
**The best hope of a triumph against COVID-19 currently rests on vaccination.** Globally, some 200 COVID-19 vaccines are moving through development and clinical trials at unprecedented speed.<sup>11</sup> As of the end of January 2021, 12 COVID-19 vaccines had reached phase III clinical trials and 11 have been approved for emergency use by at least one country. Total worldwide confirmed purchase orders for COVID-19 vaccines reached 7.2 billion doses (figure 2.9A), and vaccination campaigns are making progress in a number of countries (figure 2.9B).

**However, the vaccination process faces many challenges and uncertainties.** The regulatory approval process for COVID-19 vaccines may not keep up with the planned vaccinations due to vaccine safety concerns. Even with

<sup>11</sup> This information is valid as of 25 January 2021. Fresh information may be obtained from Duke University's Launch & Scale Speedometer: Weekly Vaccine Research Updates, which is available at <https://launchandscalefaster.org/COVID-19>.

**Figure 2.8**

**Heat map of new COVID-19 cases, five-day moving average**



Source: ESCAP, based on WHO data.

Note: The dark red color indicates higher number of new COVID-19 cases, while the light green color indicates lower number of new COVID-19 cases.

scaled up vaccine production, it may still take years before enough vaccines could be manufactured to provide everyone with effective protection. Some vaccines also require storage at ultralow temperatures, adding further difficulties to their shipment and distribution. How soon the global population can reach so-called herd immunity and how effective these vaccines will be against new COVID-19 variants also remain uncertain.

**Developed countries are much better protected against such uncertainties compared with developing countries.** The current procurement and roll-out of COVID-19 vaccines is extremely uneven. As of 25 January 2021, high-income countries secured orders for 4.2 billion COVID-19 vaccine doses (figure 2.9A), 58 per cent of the world's total, despite representing only some 15 per cent of the world's population. They also lead by significant margins in the number of doses of COVID-19 vaccines administered (figure 2.9B) and are

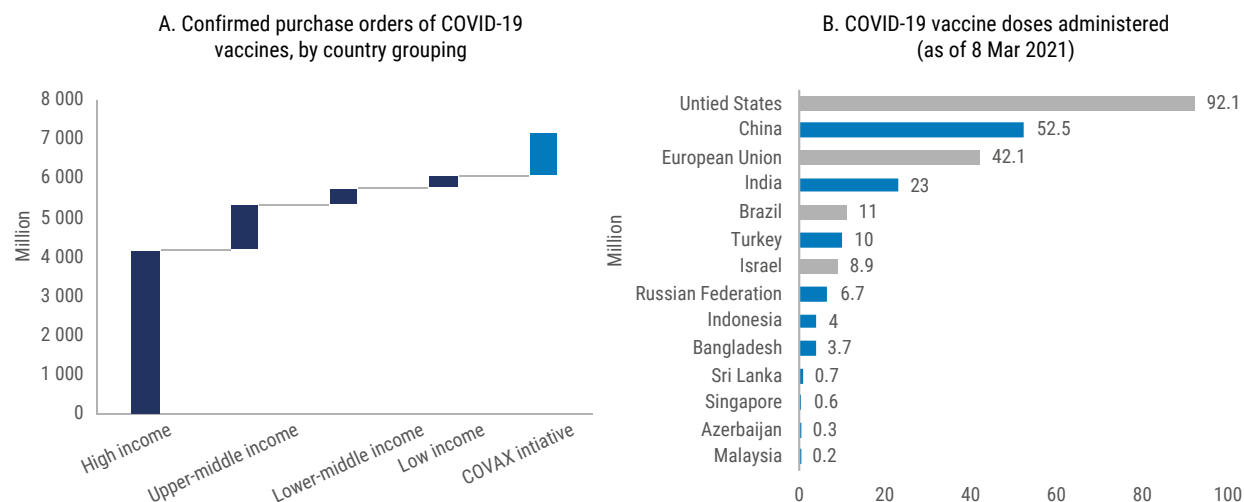
better protected against unexpected supply or delivery shortfalls, being the developers and manufacturers of the leading vaccines.

**In contrast, multilateral efforts in helping developing countries in the fight against COVID-19 are inadequate.** The primary multilateral programme for collective response to COVID-19, Access to COVID-19 Tools Accelerator, faced a 68 per cent funding gap (\$26 billion) as of late January 2021.<sup>12</sup> Even if its vaccine support pillar, COVID-19 Vaccines Global Access (COVAX), could be fully

<sup>12</sup> Based on WHO Director-General's opening remarks at a media briefing on COVID-19 on 25 January 2021.

**Figure 2.9**

**Purchases of COVID-19 vaccines, and number of people receiving such vaccines**



Source: Source: Panel A. COVAX Global Supply Forecast, March 2021;<sup>a</sup> and Panel B. Our World in Data.

<sup>a</sup> Available at: <https://www.gavi.org/sites/default/files/covid/covax/COVAX%20Supply%20Forecast.pdf>.

implemented in time, it is expected to cover just 27 per cent of the target population by the end of 2021.<sup>13</sup>

COVAX currently supports 30 Asia-Pacific developing countries<sup>14</sup> under the Advance Market Commitment programme, and an additional 9 under the Self-Financing Participants programme.<sup>15</sup> Given the inadequacy of the current roll-out plan, most of these countries may still need to rely primarily on existing pandemic control measures in 2021 before effective protection by vaccination

could be achieved in 2022, making post-pandemic recovery more time-consuming and bumpy.

### 3.2. The risk of a K-shaped recovery

**A “K-shaped” recovery, both within and across countries, over the forecast period is very likely.** This is driven by multiple factors:

- First, given the highly uneven progress in COVID-19 vaccination across countries, most Asia-Pacific developing countries may remain exposed to the pandemic threat for another year or two;
- Second, the unequal sectoral impact of the COVID-19 pandemic will significantly delay the recovery of countries dependent on global tourism as well as low-skill, contact-intensive manufacturing and services;
- Third, policy space, especially fiscal, for supporting a robust recovery over the forecast period, is highly uneven across countries. Those countries incapable of ensuring policy continuity or response to new challenges would be highly vulnerable in the recovery process;
- Fourth, the digital and technology divide and economic capability gaps may lead to substantial cross-country divergence in their adaptation to the new normal, such as teleworking, digitalization and automation, in the post-pandemic economy;

<sup>13</sup> For further information, see [www.gavi.org/sites/default/files/covid/covax/COVAX%20Supply%20Forecast.pdf](https://www.gavi.org/sites/default/files/covid/covax/COVAX%20Supply%20Forecast.pdf).

<sup>14</sup> Afghanistan, Bangladesh, Bhutan, Cambodia, Democratic People's Republic of Korea, Fiji, India, Indonesia, Kiribati, Kyrgyzstan, Lao People's Democratic Republic, Maldives, Marshall Islands, Micronesia (Federated States of), Mongolia, Myanmar, Nepal, Pakistan, Papua New Guinea, Philippines, Samoa, Solomon Islands, Sri Lanka, Tajikistan, Timor-Leste, Tonga, Tuvalu, Uzbekistan, Vanuatu and Viet Nam.

<sup>15</sup> Armenia, Azerbaijan, Brunei Darussalam, Georgia, Iran (Islamic Republic of), Malaysia, Nauru, Republic of Korea and Singapore.

- Last but not least, the disproportionate impact on livelihoods and income potentials of the most vulnerable and poorest population groups may result in widening inequality gaps and growing social resentment and instability. Poorer developing countries would be more prone to such a threat.

### 3.3. Fiscal and monetary risks – debt sustainability and supply-side shocks

#### Higher public spending as a response to the COVID-19 pandemic coupled with sharp declines in revenue due to economic contraction have resulted in wider fiscal deficits.

Among Asia-Pacific developing countries, the average fiscal deficit is projected (under considerably uncertain conditions) to widen from 1.5 per cent of GDP in 2019 to 6.8 per cent in 2020 and 5.6 per cent in 2021 (figure 2.10) (Lee, 2020). The deterioration in fiscal position is sharper and potentially more persistent than that of the 2008 global financial crisis.

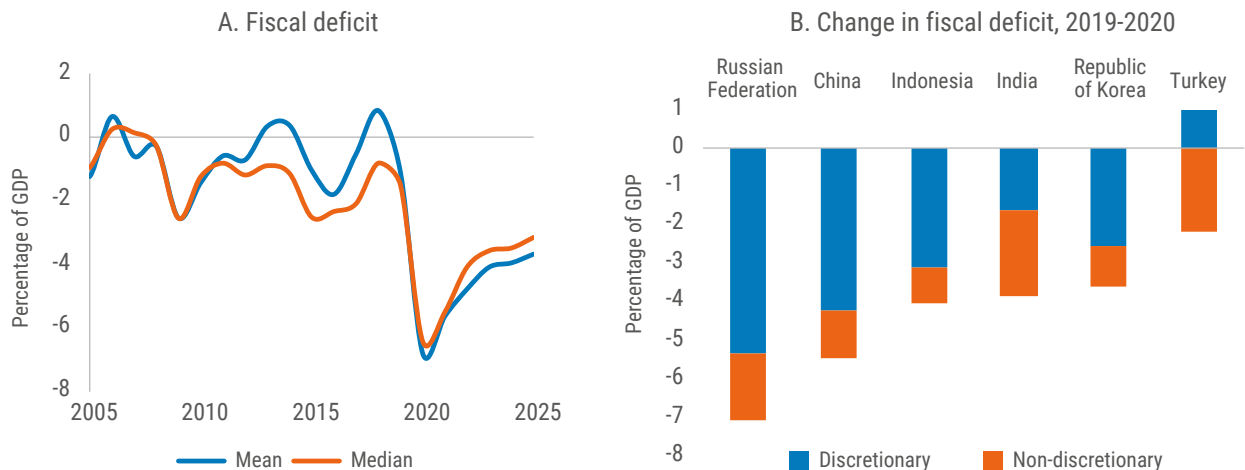
**Larger fiscal deficits and deep economic recession in 2020, together, pushed up public debt-to-GDP ratios across the board** (figure 2.11). Debt ratios are expected to rise in 38 of 44 Asia-Pacific developing economies, with the average<sup>16</sup> public debt-to-GDP ratio projected to increase from approximately 51 per cent in 2019 to 61 per cent in 2020 and 63 per cent in 2021.

<sup>16</sup> Unweighted simple average. Movement in median follows the same pattern.

Even though debt levels in most Asia-Pacific developing countries remain below the commonly used 60 per cent debt-to-GDP benchmark and, overall, the region is not as indebted as other developing regions in the world, **the quick build-up of debt still raises concerns over debt sustainability in a number of countries.** Fiji and Maldives, for example, saw their public debt-to-GDP ratios surging by more than 30 percentage points in 2020 alone. Debt ratios in Bhutan also increased by more than 15 percentage points and surpassed 80 per cent of GDP in 2020. In a scenario of prolonged economic stagnation, fiscal sustainability could become a serious policy challenge for these countries. Under such a scenario, policy experiments on unconventional monetary measures (section 2.2, figure 2.5B), especially direct public debt financing, carry certain risks, such as financial repression, erosion in incentives to undertake needed fiscal reforms, prolonged debt distress,

**Figure 2.10**

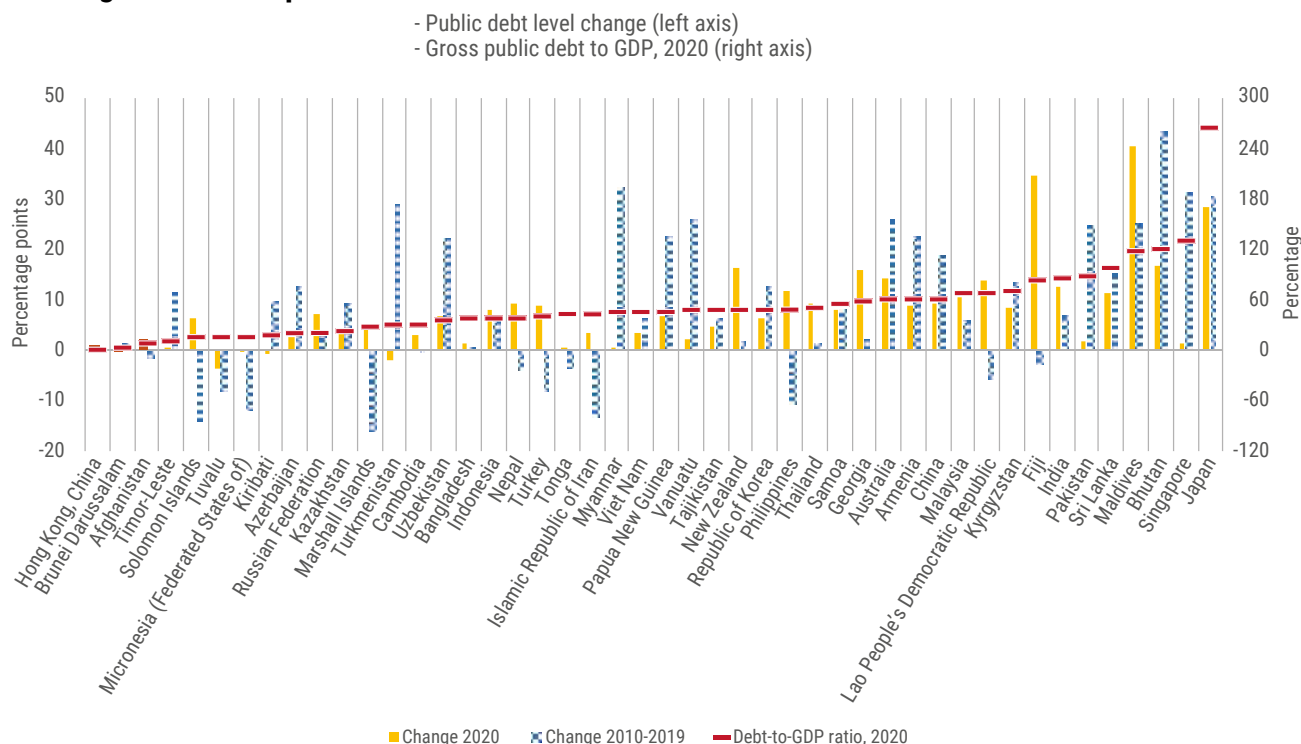
#### Projections for fiscal deficits



Source: Lee (2020).

**Figure 2.11**

# Changes in level of public debt



Source: ESCAP calculations, based on IMF World Economic Outlook. Accessed on 24 February 2021.

uncertainty around the inflation outlook and damage to central bank independence and credibility, if not managed with caution.<sup>17</sup>

In addition, **prolonged and significant socioeconomic disruptions could lead to long-lasting supply side effects.** Extended periods of unemployment or partial employment could adversely affect labour productivity. Education disruptions, especially for those ill prepared for the adaptation to distance learning, also weigh on long-term human capital formation and future economic productivity. Cheap credit could end up funding unprofitable businesses and unproductive investments, resulting in an increase in “zombie firms” and

non-performing loans. Although the subdued aggregate demand may keep inflation pressure low in the forecast period, **a vicious combination of high public spending, monetary easing, excessive financial leveraging and subdued long-term productivity on the supply side could increase the risk of future stagflation.**

## 3.4. Trade tensions, “tech decoupling” and value chain adjustments – mixed blessings

Although trade tensions and rising protectionism became secondary concerns during the pandemic, they pose continuing downward risks to the near-term economic outlook. Meanwhile, new risk factors emerged in 2020, including intensified tech decoupling between China and the United States, new calls for reshoring driven by security concerns over essential supplies, and potential value chain adjustments induced by the COVID-19 pandemic. Such developments have rendered the external economic environment much more uncertain and unaccountable, thus obliging countries to look inwards for certainty.

<sup>17</sup> For more detailed discussion, see box 5.1, chap. 5.



## Trade tensions, protectionism and tech decoupling

**The year 2020 witnessed a further boost in protectionist sentiment.** When the pandemic began, initial shortfalls in medical supplies triggered an outcry for greater sovereign control over supply chains and self-sufficiency. Although these arguments subsequently died down when global value chains stepped up much faster than domestic production to meet the global demand, an increase in emphasis on national security over economic reasoning and further pressure for reshoring should be expected. Furthermore, widened inequality gaps as a result of the pandemic will lead to further resistance to globalization, especially among groups not benefiting from or fully compensated for it (Antras, 2020).

In parallel, **the China-United States tech decoupling deepened while trade tensions did not escalate further.** In 2020, the United States introduced broader and much more stringent restrictions on Chinese companies' access to American technology and third-party inputs using American technology, forcing semiconductor suppliers in the Asia-Pacific region to make a choice between their two largest business partners. Although tech decoupling is likely to be limited to pioneering technology sectors of strategic importance, a potential outcome of tech-fragmentation in the Asia-Pacific region's high-tech value chains and its disruptive effect should not be overlooked.

## Value chain adjustments

**Production disruptions during the pandemic may have shifted the value chain focus from cost-efficient production to resilience-building.** Shortened supply chains, greater redundancy in value chain configuration, larger buffer stocks of supplies, supplier diversification to reduce overdependence and digitalization for more efficient resilience management could become more common. Such needs, together with persistent trade tension and protectionism pressure, may also accelerate value chain relocation closer to end markets.

**The adoption of automation and other labour-saving technologies is likely to be accelerated.** Replacing unskilled or low-skilled labour with additional capital investment in automation and robotization was already an evolving trend before the pandemic, when producers facing wage pressures sought to keep production closer to local supply chains and end markets instead of moving to places with lower wages. The pandemic has amplified the risk of human factors in

production processes and may push more companies towards making labour-saving adjustments in the post-pandemic recovery. This may result in fiercer competition among low-income countries for attracting FDI as well as structural shocks in the job market. Although evidence suggests that automation may eventually generate greater outsourcing demand and more jobs (World Bank, 2020b), managing the short-term structural disruptions will be a challenge.

## 4. Near-term economic policy considerations

Most Asia-Pacific developing countries will be confronted with multiple policy challenges in the post-pandemic recovery phase, including continuing COVID-19 outbreaks, heightened uncertainties, weaker economic fundamentals and a further squeezed policy space. In the near term, policymakers would need to prioritize a small number of key policy efforts rather than spreading them too thinly across many areas. ESCAP has identified five such priorities, namely **pandemic control, inclusive recovery, continuity in fiscal and monetary support, policy quality and synergies, and regional alliance building.**

### 4.1. Put pandemic control first and leverage regional cooperation

**Containing the pandemic should remain the first and foremost policy priority.** While the roll-out of COVID-19 vaccines has started, for most Asia-Pacific developing countries adequate protection will be achieved only in 2022 (section 3.1). Thus, during the transition period before achieving herd immunity through vaccination, countries would have to

continue to rely on current methods for pandemic control. These include strict lockdowns, physical distancing measures, targeted quarantines supported by mass testing and contact tracing, and self-protection through hand-washing or mask-wearing. Each country would have to learn from its own experience and make policy choices according to its unique needs and constraints.

**Regional cooperation could effectively complement global support to developing countries in COVID-19 vaccination programmes.**

Uneven progress in vaccine roll-outs would significantly delay the elimination of COVID-19 worldwide, and a prolonged threat would incur significant economic costs for all countries (International Chamber of Commerce Research Foundation, 2021). The Asian and Pacific region is ideally positioned to make complementary regional efforts in assisting smaller, poorer and more vulnerable developing countries in the region in terms of COVID-19 vaccination. The region's three largest developing countries, China, India and the Russian Federation, are at the frontier of COVID-19 vaccine development and roll-out. Together, they own 7 of the 11 COVID vaccines currently approved by at least one country and possess significant vaccine production capacity. At the same time, their close economic ties with regional neighbours mean that helping neighbours also directly serves their own economic interests.

**Such regional cooperation can take many forms.** Although European Union-style collective vaccine procurement could be difficult to replicate for the Asia-Pacific region,

both the Association of Southeast Asian Nations (ASEAN) and the South Asian Association for Regional Cooperation (SAARC) have set up COVID-19 funds at the subregional level. Such initiatives could be further expanded to support more inclusive COVID-19 vaccination within the respective groups. Expanded bilateral cooperation could be another option. Asia-Pacific developed countries, such as Australia in the Pacific subregion, have provided extensive support to their developing neighbours in the fight against COVID-19. China and India have also donated COVID-19 vaccine doses for emergency use in neighbouring countries. Such bilateral cooperation could be more flexible and cost-efficient under specific settings.

## 4.2. Prioritize inclusiveness for a robust recovery

Given the pandemic's impact on economic inequality and the risk of a K-shaped recovery, focusing on inclusiveness in the post-pandemic recovery phase will serve three specific purposes.

**First, leaving no country behind, especially in the COVID-19 vaccination process, serves the common interest of all countries.** A recent International Chamber of Commerce Research Foundation (2021) study estimated that failure to ensure developing country access to COVID-19 vaccines could result in an economic output loss valued between \$1.5 trillion and \$9.2 trillion globally in the coming years, most of which would be borne by rich countries. In contrast, the resources required to provide low- and lower-middle-income developing countries with very basic vaccine protection against COVID-19 represents less than 1 per cent of this potential economic loss and is well within the financial capacity of rich countries. The maxim "Helping others is helping oneself" has never been truer than in the context of this global pandemic.

**Second, leaving no one behind within countries helps States hedge the risk of post-pandemic social unrest.** The pandemic has significantly increased poverty in Asia and the Pacific and widened inequality gaps. These are both potential sources of social unrest if left unaddressed. Indeed, recent research suggested that there is positive linkage between epidemics and social unrest (Barrett and Chen, 2021). If such unrest materializes, its disruptive power could erase much of the economic gains achieved during the recovery phase and inflict even more permanent damage on long-term economic development. In this sense, **only an inclusive recovery would be a robust one.**

**Third, inclusive recovery can better support the rebound in aggregate demand.** Economic dynamics during the pandemic suggest that private consumption and demand are likely to recover more slowly than production. A prolonged mismatch as such would result in overcapacity, which would weigh on economic growth and force more public spending (thus also more public debt) in order to bridge the gap. As poorer households have much greater marginal propensity to consume (Carroll and others, 2017), inclusive recovery can thus be the best way to restore aggregate demand while helping the poor mitigate long-term damage to their productivity.

### 4.3. Ensure continuity in fiscal and monetary support

**There is a strong case to be made for continuation of fiscal support for post-pandemic recovery.** First, the economic recovery remains fragile and significant slack remains. When most economies in the region are still running significantly below potential, public stimulus needs to stay in place to consolidate the recovery (Casado and others, 2020; IMF, 2020a; Stone, 2020), as demonstrated in chapter 3. Second, livelihoods of Asia-Pacific developing countries' poor and vulnerable were devastated during the pandemic, and many people continue to depend on extended public support for basic needs. A premature tightening or withdrawal of support would result in immense suffering and social resentment. Third, fiscal multipliers tend to be high when both employment and investment are low (Auerbach and Gorodnichenko, 2015; Berge, De Ridder, and Pfajfar, 2020; Blanchard and Leigh, 2013). Hence, it makes sense to continue with public sector investments to maximize the potential benefits. Last but not least, fiscal and monetary policies need to ensure continuity and predictability and be prepared for new adverse shocks as economies are more sensitive to heightened uncertainty and may react in an unwarranted manner in the post-pandemic context.

**Monetary policies can also be proactive in complementing and supporting fiscal measures, while supporting financial stability and keeping an eye on inflation risk.** A certain level of coordination between fiscal and monetary policies appears to exist in Asia-Pacific developing countries' responses to COVID-19, when they leveraged aggressive monetary measures to compensate for the limited fiscal space. Relatively low inflationary pressure, abundant international liquidity and a weak United States dollar may have also opened some space for monetary policies' supportive role

for fiscal expenditure, as reflected in the experiments on asset purchasing and outright public debt financing by developing countries in the region (section 2.2). However, as discussed in box 5.1 in chapter 5, great caution is required in using these unconventional measures.

### 4.4. Strengthen policy quality and seek synergies

**Reap efficiency gains from better governance, investment management and planning**

**Strengthening policy quality can significantly increase developmental pay-offs on the money spent and offset part of the negative impact of the inevitable eventual fiscal consolidation** (Bosio, Grujicic, and Lavorskyi, 2020). Improved governance and public investment management pay significant dividends. For instance, ESCAP (2019b) estimated that Asia-Pacific developing countries could achieve similar levels of output or outcome in the health and education sectors while using 30 per cent less resources. Potential savings could be even higher for infrastructure investments, through better project appraisal, selection, management and implementation, as well as more effective coordination among government branches.

**Advance planning during normal times is particularly important** to avoid ill-conceived investments or inefficient spending, when projects have to be hastily put together in response to emergencies. Maintaining a healthy pipeline of well-developed candidate projects during normal times, in preparation for situations when fiscal expansion is needed

quickly, is a best practice worth spreading. In drawing on the lessons learned from this pandemic, it would also be crucial to account for potential risk factors in project development and planning.

### Balance short- and long-term policy objectives through better synergies in economic-social-environmental development

As highlighted in chapter 1, post-pandemic recovery should not involve building back to the pre-pandemic routine but instead building forward towards more sustainable and resilient economies. The speed and severity of the COVID-19 shock and the limited policy space have forced many Asia-Pacific developing countries primarily to prioritize immediate economic and livelihood concerns, while investments in long-term social well-being and environmental sustainability, as outlined in the “building forward better” package of chapter 4, have so far been limited. However, **as the recovery efforts exit the initial phase of emergency response, countries should direct greater attention to long-term sustainable development needs and programmes.**

**In the near term, policy focus could be put on investments and interventions with the greatest synergy between economic pay-offs and social-environmental benefits,** when fiscal space remains tight and restarting the economy remains a foremost priority. These can include investments in the following synergy areas:

- **Health and education:** Investment on these two fronts directly promote the accumulation of human capital, which is a

determinant of long-term labour productivity and economic growth potential. It also has great synergy with the immediate post-pandemic recovery needs to offset negative impacts of the COVID-19 pandemic on labour productivity due to prolonged unemployment and education disruptions. Special emphasis should be placed on the inclusiveness of health and education spending. In particular, public support for workplace health and pandemic prevention, especially in low-skill, contact-intensive sectors, and effective and equally accessible distance learning solutions are particularly important in the post-pandemic context;

- **Infrastructure:** Social and green infrastructure projects deliver a natural synergy between the economic pillar and the social-environmental pillars. Among them, those targeting local, negative economic externalities and risk management, such as sewage or pollution treatment, disaster mitigation or climate adaptation, may deliver significant economic dividends. Here, upgrading efficiency-oriented infrastructure, such as building retrofitting, decentralized renewable energy solutions or grid upgrading for energy-saving purposes, could provide the most immediate economic synergies in employment, efficiency and output (Agrawala, Dussaux, and Monti, 2020; IEA, 2020);
- **High-tech green sectors:** The “sunrise” green sectors, such as renewable energy, electric vehicles, advanced energy storage and related high-tech services, provide enormous economic potential as global actions on climate change gather growing momentum. Asia-Pacific countries possess competitive advantages in these high-tech, high-value-addition sectors and can easily find synergies between their economic and environmental strategies here. The new carbon “net-zero” pledges by China, Japan and the Republic of Korea in 2020 and their generous public support for local capacity in these high-tech green sectors, for instance, represent to an extent such strategic synergies.<sup>18</sup>

### 4.5. Seek alliances with regional partners

Despite the initial stumbles in early 2020, regional trade and value chains demonstrated resilience to the COVID-19 shock and played an important role in the Asia-Pacific region’s recovery from the recession. Such resilience could prove

<sup>18</sup> For additional discussion on collective Sustainable Development Goal actions in North-East Asia, see ESCAP (2020c).

as valuable in the post-pandemic world, characterized by increased trade friction and external economic uncertainty. The growing emphasis on consumer market proximity and shortened value chains also implies greater potential for regional economic integration. For Asia and the Pacific, ongoing trade tensions, potential tech decoupling and the domestic economic upgrading and rebalancing needs of China may add further impetus to value chain reconfiguration and reallocation within the region. An integrated regional market and more harmonized trade and investment rules may facilitate this process, which can potentially serve the interest of all parties.

The signing of the Regional Comprehensive Economic Partnership Agreement at the end of 2020 is a testimony to this spirit. The Agreement brought together the ASEAN block and its five main trading partners, namely Australia, China, Japan, New Zealand and the Republic of Korea, to form the world's largest free-trade area, which represents 29 per cent of the global economic output and 30 per cent of the global population. Through the harmonization of pre-existing bilateral trade agreements between the signing parties and new commitments to common rules, practices and standards (ADB, 2020), the Agreement is expected to increase its members' real income by \$165 billion by 2030 (Petri and Plummer, 2020). However, the greatest benefit of the Agreement is perhaps its symbolic message that Asia-Pacific countries remain committed to economic openness and cooperation, at a time when global commitment to economic multilateralism is at its lowest level.

## 5. Conclusions

The COVID-19 crisis is unique in three aspects. First, it is a resounding reminder of the interconnectedness between economic performance and non-economic factors and of the need for a broadened economic policy vision that is not confined to one profession only. The pandemic has demonstrated that prioritization of health responses was indispensable in the economic recovery strategy, and simultaneous policy efforts on both economic and non-economic fronts may generate the best results.

Second, the pandemic has had a direct and disproportionate impact on the livelihoods of the poorer and more vulnerable

groups in the region. Most policy response packages had components of direct support to households and workers, while targeted assistance for vulnerable people and entities, such as SMEs, also became more common. It is important that more elements of inclusiveness be included in post-pandemic recovery packages.

Third, the crisis amplified the resource allocation dilemma confronting developing countries, when health, social and economic priorities all had to compete for limited budgets. Important areas, such as green development, were inevitably marginalized in this process when policymakers decided on difficult policy trade-offs. This highlights the importance of policy quality and synergies to maximize developmental impact and also calls for deepened development cooperation, especially in the pandemic context when helping others is also helping oneself.

The COVID-19 crisis has been an unprecedented economic blow to the Asia-Pacific region, but it has also taught valuable policy lessons that should not be overlooked in the ongoing recovery from the shock. In particular, **an economic policy vision rooted in the broader context of sustainable development, prioritization of people and inclusive recovery, efforts to strengthen policy quality and seek development synergies, and a spirit of development cooperation** for mutual benefits and towards shared objectives can guide future policymaking. The subsequent chapters will discuss specific policy options in the medium to long term.







# Chapter 3

## Understanding Resilience: Lessons from Past Crises and Recoveries

### 1. Introduction

**The Asia-Pacific region is no stranger to crises which leave behind severe economic impacts.** In Indonesia and Thailand, the 1997 Asian financial crisis was associated with a medium-term output loss of 69 per cent and 109 per cent of GDP respectively, as well as large increases in public debt (Laeven and Valencia, 2018). In the Pacific islands, where natural disasters are frequent, since the 1980s an average disaster event caused damage valued at 14 per cent of GDP and adversely affected 11 per cent of the population (Lee, Zhang and Nguyen, 2018).

**Shocks leave behind long-term scars, including social and environmental damage.** A rebound from crises should not be mistaken for recovery, as income levels could remain permanently lower than the pre-crisis trend (Cerra and Saxena, 2008; 2017). Adverse events cause long-term harm to productivity (Dieppe, Celik and Okou, 2020). From financial crises to pandemics, shocks tend to increase income and wealth inequality (Kuhn, Schularick and Steins, 2018; Furceri and others, 2020; Cerra and others, forthcoming). Recessions could divert resources away from environmental protection and investments needed for building a low-carbon, climate-resilient future. Tighter financial constraints discourage firms from complying with environmental, social and governance standards (IMF, 2020b).

While much economic research has been focused on “how to grow faster”, **relatively less attention has been given to the issue of “how to reduce setbacks”, that is, build resilience.** However, this is an important question, as research on modern economic history reveals that improved long-run economic performance has occurred primarily through a decline in

the rate and frequency of shrinking, rather than through an increase in the rate of growing (Broadberry and Wallis, 2017). As also highlighted in chapter 1, it is the frequency and the depth of recessions that has held developing countries back from their developmental journey (Cerra and Saxena, 2005; 2017).

**In drawing lessons from the past, this chapter examines how policy choices can safeguard sustainable development in times of crisis** (figure 3.1). Asian countries were more resilient to the 2008 global financial crisis thanks to lessons learned from the 1997 Asian financial crisis. Instead of adopting abrupt fiscal austerity and interest rate increases, countries responded by implementing countercyclical stimulus measures (Park, Ramayandi and Shin, 2013). At the same time, pre-crisis policy choices do matter. Flexible exchange rate regimes and local currency bond markets adopted in the wake of the 1997 financial crisis helped Asian countries cope with future financial shocks. Similarly, in the context of natural disasters, early warning systems, climate-resilient

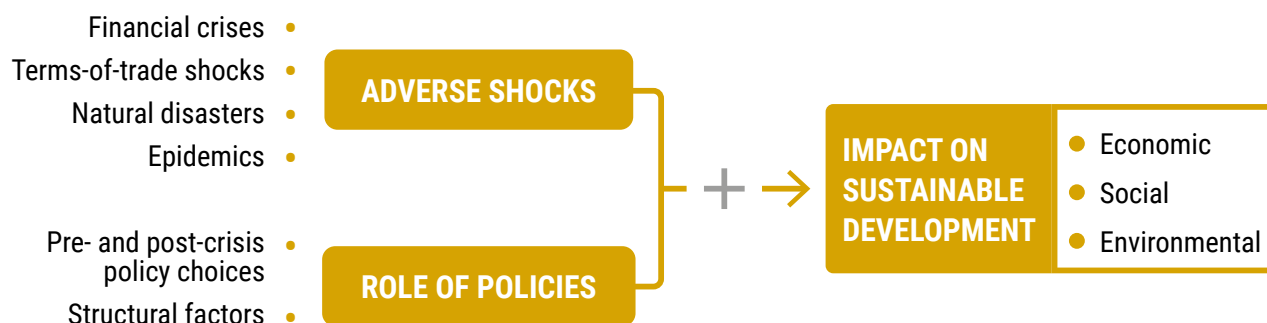
infrastructure and insurance mechanisms could reduce human and economic losses (United Nations, 2017a).

**The present chapter addresses the following policy questions:** **First**, how do adverse shocks affect economic, social and environmental outcomes? How deep and persistent are the losses? **Second**, are policies effective in mitigating the losses? Do pre-crisis vulnerabilities (structural factors) amplify shocks? **Third**, where do countries currently stand on crisis preparedness? How wide is the “resilience gap” of the least developed countries?

**The main findings.** **First**, from financial crises to natural disasters, adverse shocks reverse hard-won gains across the three dimensions of sustainable development. They result in lower income, wider inequality, higher unemployment, slower accumulation of human and physical capital, and weaker environmental performance. **Second**, policy choices do matter. Countries with more supportive macroeconomic policies in times of crisis recover faster and avoid deeper scars. Health and social protection systems, quality of infrastructure and economic diversification are important factors for resilience. Over the medium term, a financial crisis lowers GDP per capita by less than 1 per cent in countries which score high on these factors and respond aggressively to shocks compared with more than 3 per cent in other countries. An epidemic sets back educational outcomes by half a year in the former countries compared with a year and half in the latter. A natural disaster sets back environmental performance by less than a year in the former compared with more than six years in the latter, as measured by a composite index of environmental health and ecosystem vitality.

**Figure 3.1**

### **A comprehensive approach to assessing resilience to shocks**



**The main recommendations.** **First**, countries should respond aggressively to adverse shocks in order to minimize the reversal of hard-won gains. To safeguard sustainable development, countries should opt for strong and swift responses to shocks rather than end up with “too little, too late”. **Second**, risk management should become part and parcel of development planning and policymaking. Policymakers should assess how persistent and cross-cutting are the likely impacts of shocks and identify pre-crisis and post-crisis measures that will enhance resilience. **Third**, international assistance towards least developed countries should be strengthened. In addition to addressing specific areas of vulnerability, continued attention to structural factors, such as human development and economic diversification, is needed in these countries.

## 2. The risk landscape: breaking the silos between economic and non-economic shocks

**The need for a systemic approach to building resilience has been recognized by the global development community for some time.** In 1999, the United Nations Committee for Development Policy introduced an “economic vulnerability index” as one of the criteria for identification of least developed countries, with subindices covering terms-of-trade shocks and natural disasters.<sup>1</sup> In the Asia-Pacific region, the Commission at its sixty-ninth session in 2013 deliberated on building resilience to natural disasters and major economic crises<sup>2</sup> in the wake of a series of major disasters, including the 2011 earthquake and tsunami in Japan and the continued economic challenges following the 2007/08 global food price and fuel crisis and the 2008 global financial crisis, referred to collectively as the “triple crisis”. Similarly, the World Bank in 2013 released an evaluation of how that institution had responded to recent crises, including pandemics, and in the following year published a report calling for integrated risk management.<sup>3</sup>

**A better understanding of the complex risk landscape has become imperative in the wake of the COVID-19 pandemic.** The public health emergency it caused soon turned into

social and economic crises, as lockdown measures affected livelihoods. Despite very low infection rates, Pacific island countries faced huge economic losses through tourism and remittance channels. This phenomenon illustrates that the economic risk of a pandemic is different from its health risk (Noy, Doan and Taupo, 2020). Countries which had entered the pandemic with relatively limited fiscal space could face a sovereign debt crisis, which would make their recovery even more difficult. The COVID-19 pandemic is a reminder that *looking at economic shocks and outcomes separately from non-economic shocks and outcomes fails to address the interlinkages and will end by achieving only partial solutions*. A comprehensive approach is needed in line with the 2030 Agenda for Sustainable Development.

**A first step towards enhancing resilience is to map out the risk landscape, or “risk-scape”.** This chapter considers four types of shocks: financial crises; negative terms-of-trade shocks; natural disasters; and epidemics/pandemics. The first two could be classified as **“economic” shocks**, which fall under the purview of finance ministries, central banks and financial regulators, and ministries of commerce and industry. Typically, the largest economic costs are associated with external financial shocks for emerging markets and with terms-of-trade shocks for low-income developing countries (Becker and Mauro, 2006). The last two could be classified as **“non-economic” shocks**, which fall under the purview of national disaster management agencies, ministries of health and centres for disease control and prevention. In the past

<sup>1</sup> For further information, see <http://unohrrls.org/about-ldcs/criteria-for-ldcs/>.

<sup>2</sup> The home page for that session contains links to statements, documents and other information of value, which are available at [www.unescap.org/commission/69](http://www.unescap.org/commission/69).

<sup>3</sup> For details, see World Bank (2013; 2014). More recently, the 2018 session of UNCTAD Trade and Development Board called for resilience to multiple shocks affecting people and sustainable development, while OECD has been promoting a systemic resilience approach to economic challenges.

two decades, natural disasters killed some 1.3 million people, affected 4.4 billion others and caused direct economic losses worth nearly \$3 trillion globally (UNDRR, 2018). Even before the emergence of COVID-19 disease, epidemics and pandemics were identified as a severe threat (Monaco and Gupta, 2018).

**For the Asia-Pacific region, the chapter identifies some 450 adverse events since the 1960s**, including 78 financial crises, 182 terms-of-trade shocks, 127 natural disasters and 63 epidemics (figure 3.2). The analysis covers up to 50 countries in the region. These events are identified

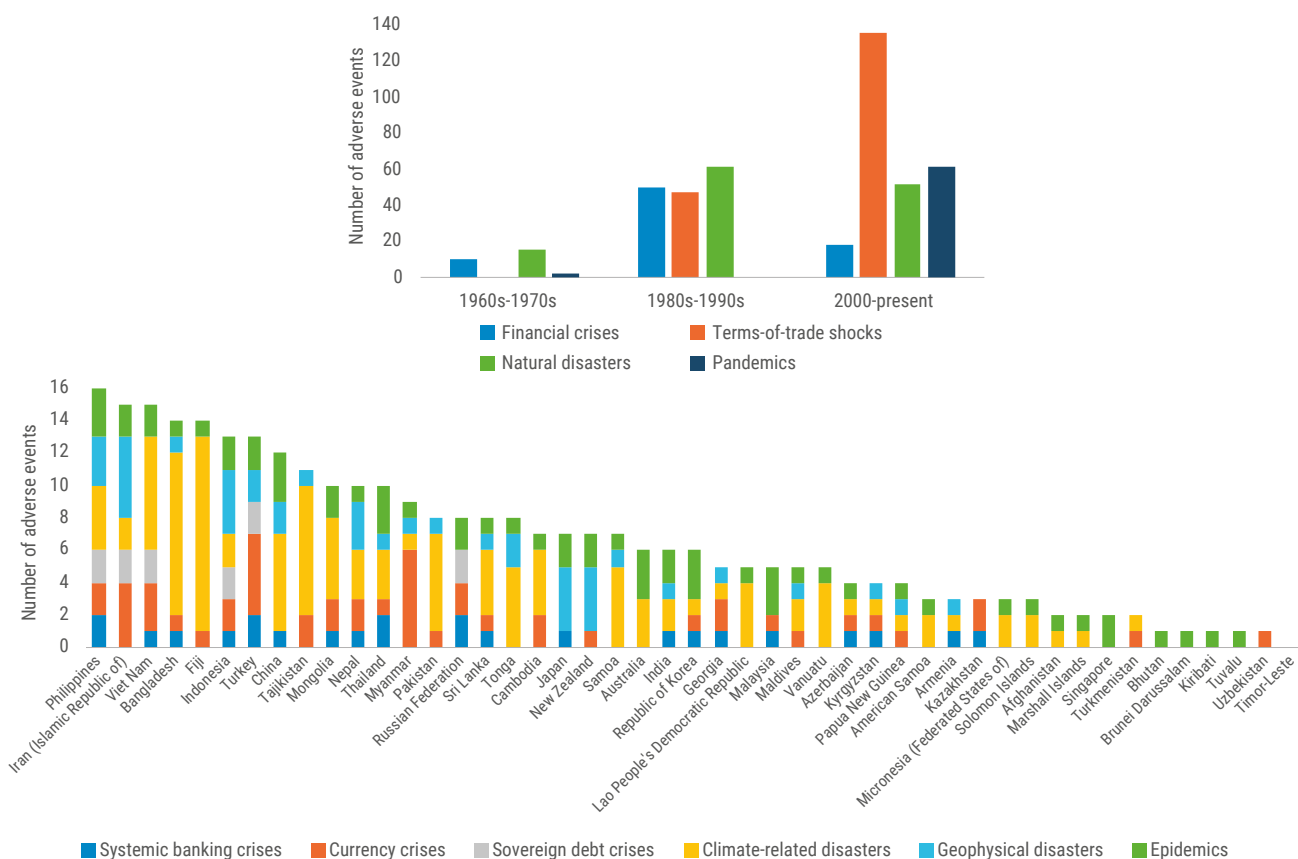
based on specialized databases, such as Laeven and Valencia (2012; 2018) for financial crises, and the Emergency Events Database (EM-DAT) for climate-related and geophysical disasters (see annex II). Figure 3.2 shows that, after 2000, *Asia-Pacific countries managed to reduce the number of financial crises but terms-of-trade shocks and epidemics have become more frequent. Natural disasters also increased in frequency*, although only severe disasters in terms of total damage are considered here. Based on this definition, such countries as *Bangladesh, Fiji, the Islamic Republic of Iran, the Philippines and Viet Nam* have experienced the highest number of adverse shocks in recent decades.

### 2.1. Financial crises: intertwined risks to banking, currency and sovereign debt

Financial crises include systemic banking crises, currency crises (or balance of payment crises) and sovereign debt

**Figure 3.2**

**The Asia-Pacific “risk-scape” analysed in this chapter**



Source: ESCAP.



crises. Globally, the average magnitude of the persistent loss in output is about 5 per cent for currency crises, 10 per cent for banking crises and 15 per cent for twin crises (Cerra and Saxena, 2008). A significant part of the costs of *banking crises* lies in the protracted and halting nature of the recovery, with more than 40 per cent of post-crisis episodes experiencing double dips (Reinhart and Rogoff, 2014). At the same time, *sovereign debt crises* have devastating effects. Latin America suffered a lost decade of no per capita income growth following the 1982 debt crisis. In Asia, there has not been a major debt crisis since the 1997 Asian financial crisis, thanks in part to the rapid growth of local currency bond markets and adjustments in macroeconomic policy frameworks.

## 2.2. Terms-of-trade shocks: commodity-dependent countries are particularly vulnerable

Negative terms-of-trade shocks could be disruptive, especially for commodity-dependent countries. On average, a 10 per cent decline in the terms of trade leads to a 2.8 per cent annual decline in GDP growth in low-income countries (Becker and Mauro, 2006). Export price shocks have larger and more persistent effects on an economy compared with import price shocks (Di Pace, Juvenal and Petrella, 2020). Commodity price volatility could make macroeconomic management challenging and discourage long-term investments. It is worrisome that many least developed countries, landlocked developing countries and small island developing States have commodity-dependent economies and that progress on economic diversification has generally been slow and limited. There are 23 Asia-Pacific economies classified as dependent on agricultural, fuel or mineral exports (see annex II).

## 2.3. Natural disasters: from climate-related to geophysical shocks, a complex “risk-scape”

Natural disasters accompany large human and economic losses. Aside from the direct damage to property and infrastructure, disasters can have broader consequences on an economy, especially if insurance coverage is low (von Peter, von Dahlen and Saxena, 2012). Regions that are more exposed to multiple hazards have wider income inequality (ESCAP, 2019a). *Climate-related disasters* are more frequent and typically account for the bulk of total damage (UNDRR, 2018); they include climatological (extreme heat and cold, droughts), hydrological (floods) and meteorological

disasters (cyclones, storms). However, *geophysical disasters* (earthquakes, tsunamis and volcanic activity) concentrated in countries, such as those in the Pacific Rim, could be catastrophic. Based on probabilistic risk assessment, disasters could also be classified into two types: those posing intensive or extensive risk; and those that are rapid or slow-onset disasters (ESCAP, 2019a).

## 2.4. Epidemics/pandemics: always with humanity but spreading faster with globalization

Throughout history, major pandemics, in addition to killing millions of people, had significant macroeconomic after-effects which persisted for 40 years (Jorda, Singh and Taylor, 2020). Pandemics in the twenty-first century – SARS (2002/03), H1N1 swine flu (2009/10), MERS (2012), Ebola (2014/15) and Zika (2015/16) – were not as devastating but nevertheless had considerable costs: real GDP was 2.6 per cent lower in the year of the outbreak and remained 3 per cent below pre-crisis level five years later (Ma, Rogers and Zhou, 2020). They also widened income inequality, lowered the employment rate for those with only a basic education and pushed more people into precarious work (Furceri and others, 2020).

## 3. Shock waves: assessing the economic, social and environmental impacts of adverse shocks

While there is no common definition of “resilience”, the term typically refers to *the capacity of individuals,*

communities and countries to withstand, adapt to and recover from adverse shocks (ESCAP, 2013). It is a multifaceted concept which does not easily lend itself to measurement or quantification. Nevertheless, for the purpose of providing empirical evidence, **this chapter adopts a methodology for estimating the depth and length of a crisis based on regression analysis** (see annex II). As an illustration, figure 3.3 shows that it took eight years for income levels in Indonesia to return to the level that existed prior to the 1997 Asian financial crisis. This has been highlighted as permanent loss (Cerra and Saxena, 2008). Such setbacks could also happen to investment, jobs, poverty, inequality, human development and environmental performance. Taken together, they present a picture of how adverse shocks undermine countries' progress towards achieving the Sustainable Development Goals.

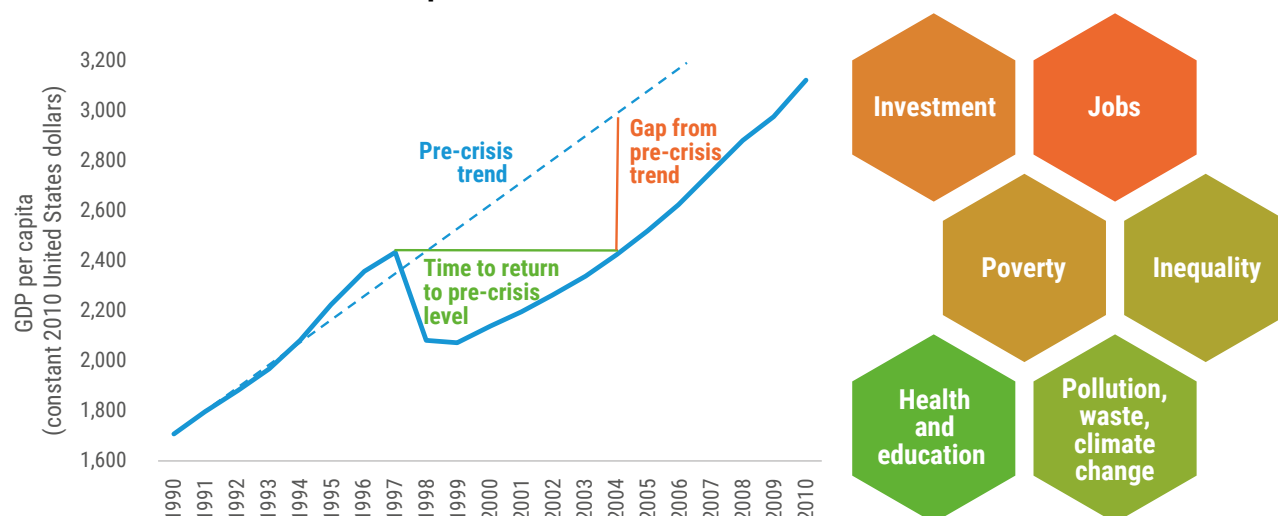
**For the Asia-Pacific region, the persistent impact of shocks is evident across the three dimensions of sustainable development** (figure 3.4). *Investment*, which is important for economic growth, jobs and poverty reduction, collapsed by nearly 20 per cent in the first year of a financial crisis and remained below the pre-crisis level five years later. The *income Gini coefficient* increased by 0.3 per cent after the SARS, H1N1 and MERS epidemics/pandemics. Given that income distribution changes only gradually over time, this is not an insignificant impact. *Environmental performance*, as measured by a composite index, declined from natural disasters. These wide-ranging impacts are discussed in detail below.

### 3.1. Economic impacts are large and persistent, and sometimes hidden

**GDP, investment and consumption.** *Financial crises* resulted in the heaviest economic loss for Asia-Pacific countries (figure 3.5), although the duration of the shock was somewhat shorter than the international experience. GDP per capita falls by 2.6 per cent in the crisis year and remains 0.8 per cent below pre-crisis level after three years, or over the medium term. This may reflect the rapid export-led recovery after the 1997 Asian financial crisis. However, the investment impact is more persistent in line with the

**Figure 3.3**

**Adverse shocks could result in permanent loss**



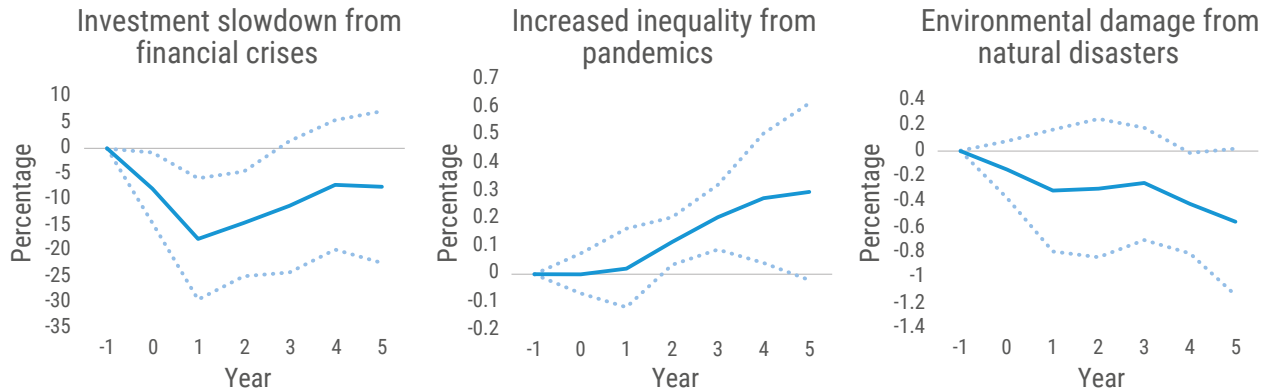
Source: ESCAP.

Note: As an illustration, the left panel shows GDP per capita in Indonesia.



**Figure 3.4**

**Adverse shocks reverse hard-won gains – economic, social and environmental**

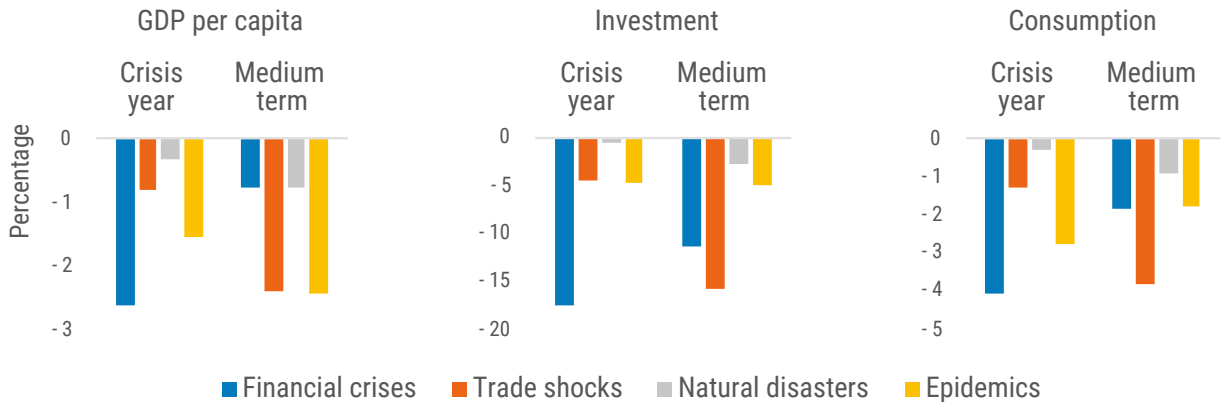


Source: ESCAP.

Note: These are average results for about 50 countries in the Asia-Pacific region for which data are available. The horizontal line at zero is the level in the year prior to the shock (the "pre-crisis level"). The dotted lines show the 95 per cent confidence interval. Horizon 0 is the year of the shock, and -1 is the pre-crisis year, which serves as the reference point.

**Figure 3.5**

**Economic impacts**



Source: ESCAP, based on the Penn World Table.

Note: "Medium term" refers to the three-year cumulative response.

findings of Cerra and Saxena (2005). While making exports more competitive, currency depreciation made the imports needed for investment more expensive. *Terms-of-trade shocks* also weigh heavily on economic activity, especially over the medium term. Commodity-dependent countries are particularly vulnerable. Epidemics weigh on investment by increasing uncertainty. While their impact is often hidden by reconstruction activities, *natural disasters* destroy the capital stock and weigh on productivity growth (Tol and Leek, 1999).

Although relatively stable compared with investment, consumption – a key proxy for welfare – drops notably. Climate-related disasters have a more persistent economic effect compared with geophysical disasters (Lee and Rojas Cama, forthcoming). This calls for urgent climate action, as will be discussed in chapter 4.

### 3.2. Social impacts are acute despite individual and community efforts

#### Unemployment and human capital.

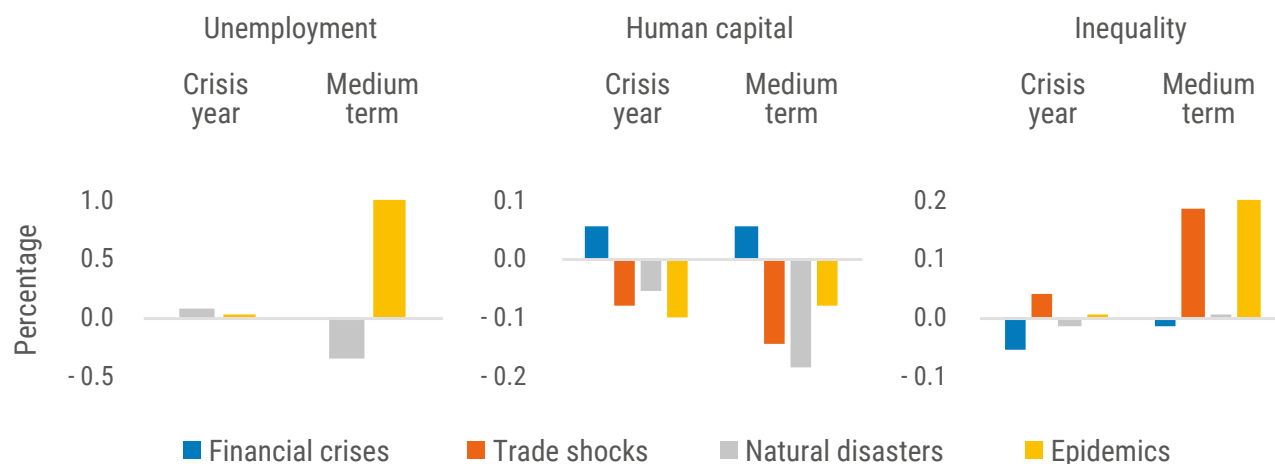
*Natural disasters* led to a short-lived spike in unemployment as economic activities were disrupted (figure 3.6). For *epidemics*, although there was no lockdown as in the case of the COVID-19 pandemic, the unemployment impact is evident over the medium term, possibly due to reallocation effects. The implications are worrisome, as those who have been unemployed tend to have lower lifetime earning potential (Pritadrajati, Kusuma and Saxena, 2021). For economic shocks, the estimation results are not statistically significant. Future studies may examine *how shocks also affect vulnerable employment and gender gaps in the labour market*. During the 2008 global financial crisis, women were more affected by job losses than men due to their concentration in small-scale manufacturing, such as textiles (UN-Women, 2014).

At the same time, *natural disasters* and *epidemics* resulted in a loss in human capital, as measured by a composite index, given their direct impact on lives and health outcomes as well as disruptions to schooling. Similar setbacks are witnessed for *trade shocks*. For *financial crises*, the impact is not so clear. With a downturn in job markets, more youth may have opted for schooling, especially higher education. It may also reflect *Asian families' strong commitment to children's health and education in times of crisis* (Frankenberg and Thomas, 2017).

**Poverty and inequality.** Estimates of poverty and inequality are based on household income and expenditure surveys, which are not carried out annually in most developing countries. Analysis on their response to shocks is therefore subject to large measurement errors. Poor communities are generally more exposed to hazards and at higher risk of contagion to epidemics. Moreover, they often resort to *erosive coping strategies*, such as selling productive assets, taking out high-interest loans and dropping out of school, *which eventually leave them trapped in poverty* despite getting some immediate relief. Such poverty impacts in turn widen inequality. This effect seems to be most evident for trade shocks and epidemics, with the income Gini coefficient increasing by about 0.2 per cent after three years (figure 3.6). Future studies may also examine the impact of shocks on multidimensional poverty and inequality of opportunities.

Figure 3.6

#### Social impacts



Source: ESCAP, based on ILOSTAT, Penn World Table and Standardized World Income Inequality Database (SWIID).

### 3.3. Environmental quality suffers from both economic and non-economic shocks

*Economic shocks* could have mixed effects on the environment. Researchers at Sussex University estimate a 1.4 to 6.2 per cent fall in **carbon dioxide, sulfur dioxide and nitrogen oxide emissions** shortly after a financial crisis, although this *positive effect disappears or reverses after one or two years*.<sup>4</sup> Businesses and households could cut down spending on **energy efficiency measures** amid financing constraints (Anbumozhi and Bauer, 2010). An increase in global financial stress and uncertainty leads to a persistent decline in firms' environmental performance (IMF, 2020b). Similarly, while reduced demand for wood could have positive effects on forest resources, economic crises could also reduce investment in **sustainable forest management** (FAO, 2009). Several Asian countries witnessed an increase in illegal logging following the 1997 Asian financial crisis.

*Natural disasters* have direct negative environmental effects. Flooded industrial sites could enable pollutants and **hazardous chemicals** to enter – untreated – into project sites, groundwater, watersheds and oceans (SWCA, 2017). Wildfires, floods and tornadoes can completely defoliate forests and disrupt **ecosystems**. At the same time, humanitarian activities during the early recovery phase may themselves not be without an environmental footprint (UNEP, 2008).

In the Asia-Pacific region, *both economic and non-economic shocks result in a persistent drop in a composite index of environmental health and ecosystem vitality* (figure 3.7). Trade shocks and epidemics had the heaviest toll on the environment, with the index dropping by more than a full percentage after three years, undoing up to five years of earlier progress. Other shocks also had negative effects, albeit milder or short-lived ones.

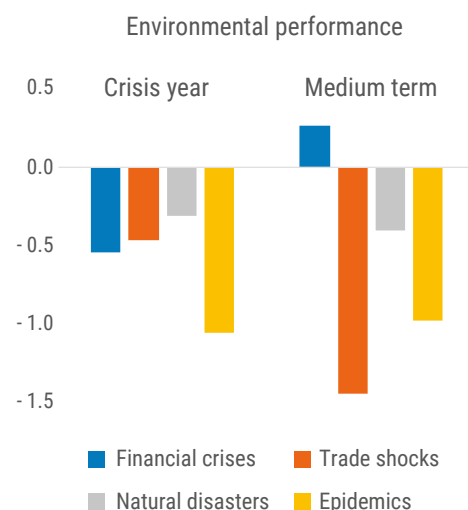
## 4. Building resilience: how policy choices and structural factors can reduce setbacks

Given the dire implications of adverse shocks, an important question concerns the extent to which **policy choices and structural factors can make a difference**. This chapter considers a wide range of policies and factors proven to be

Figure 3.7

### Environmental impact

(Percentage response of a composite index on environmental performance)

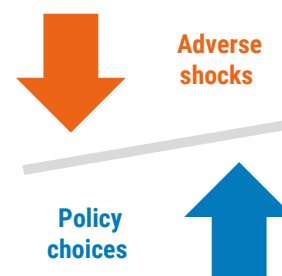


Source: ESCAP, based on Yale Center for Environmental Law and Policy.

Note: See annex II on the construction of this index.

Figure 3.8

### Multiple factors influencing resilience to shocks



Economic policies	Fiscal Policy
	Monetary and financial policies
	Reserves and exchange rate regime
	External financing
Structural factors	Health and social protection system
	Infrastructure quality
	Economic diversification
	Governance and institutions

Source: ESCAP.

<sup>4</sup> For details, see [www.sussex.ac.uk/ssrp/research/trade-debt-and-sdgs/debt-and-environmental-sustainability](http://www.sussex.ac.uk/ssrp/research/trade-debt-and-sdgs/debt-and-environmental-sustainability).

important for resilience to shocks (figure 3.8). It finds that policy choices do affect the shape of recovery (figure 3.9). For instance, financial crises led to a sharper collapse in investment in countries with rigid *exchange rate regimes* compared with peers with flexible regimes. Epidemics depressed private consumption in countries with widespread *vulnerable employment*, more than in peers with formal work arrangements. Natural disasters adversely affected education outcomes in countries with a *weak infrastructure*, more than in peers with a high-quality infrastructure. The effectiveness of policy choices and structural factors in mitigating the impact of shocks is discussed in detail below.

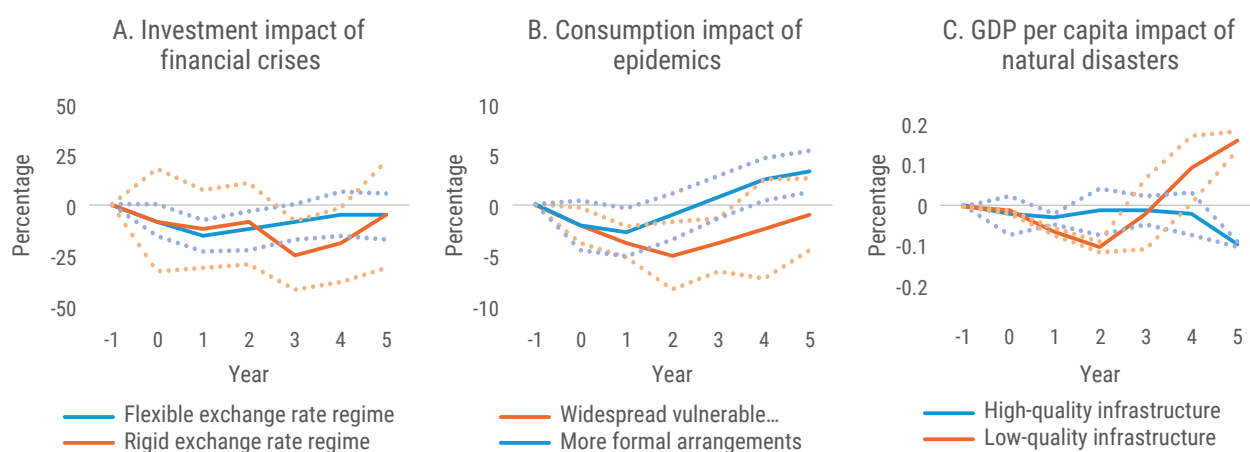
#### 4.1. Fiscal policy is central to crisis response but priorities extend beyond building buffers

As has been evident during the COVID-19 pandemic, fiscal policy plays a central role in times of crisis, and *there are tough choices to be made on the size and duration of fiscal interventions*, especially if countries face debt sustainability concerns. The implications are significant, as premature fiscal consolidation could result in a lost decade of low employment generation and wage stagnation (UNCTAD, 2020b).

**Fiscal multipliers are higher during a crisis.** Fiscal support helped countries recover faster from recessions associated with *banking crises* (Cerra, Panizza and Saxena, 2013). In contrast, following the *2008 global financial crisis*, fiscal consolidation (austerity) of 1 per cent of GDP increased the long-term unemployment rate by 0.6 percentage points and raised the Gini coefficient by 1.5 per cent within five years (Ball and others, 2013; Fatás and Summers, 2018; Ostry, Loungani and Berg, 2019). Against *natural disasters*, countries with higher levels of government spending were better able to withstand the initial shock and prevent further spillovers into the macroeconomy (Noy, 2009). Similarly, the GDP impact of twenty-first century *pandemics* prior to the COVID-19 pandemic was felt less in countries with large first-year responses in government spending, especially on health care (Ma, Rogers and Zhou, 2020). The inequality impact of

Figure 3.9

#### Policy choices matter – how countries' fortunes diverge in the wake of shocks



Source: ESCAP.

Note: For such variables as the share of vulnerable employment in total employment (centre panel) and the quality of infrastructure (right panel), the two country groups are distinguished by applying certain thresholds to their distribution. Countries which score "high" or "low" are based on whether they lie above or below the median. In some cases, the 75th and 25th percentiles are applied. For the exchange rate regime (left panel), an index ranking above 12 is classified as "flexible".

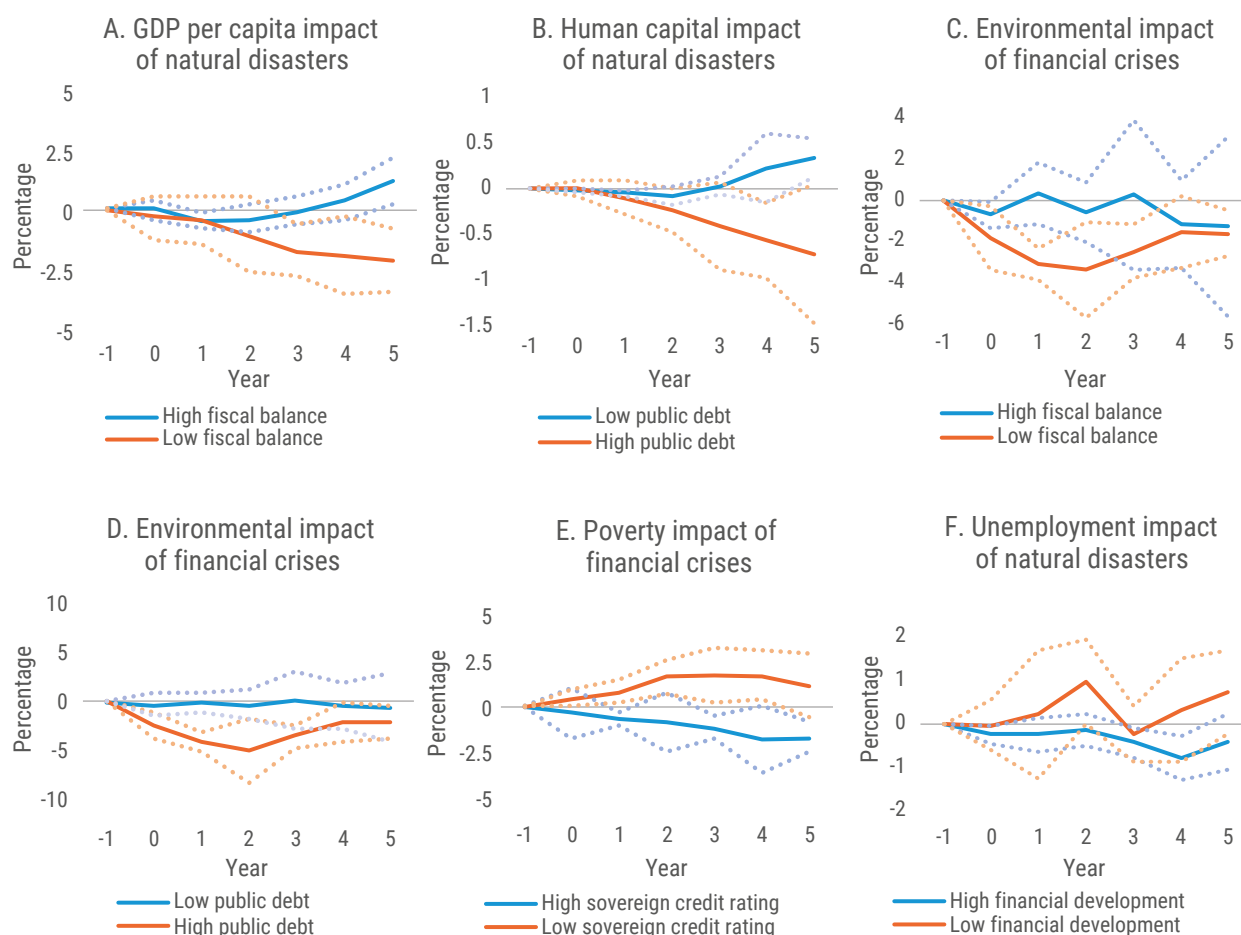
the pandemic was also felt less in countries with strong fiscal support (Furceri and others, forthcoming).

**However, the ability to finance crisis response varies.** In the Asia-Pacific region, following *natural disasters*, those countries with low government debt recovered faster than others and avoided setbacks in human capital (figures 3.10A and 3.10B), as fiscal space allowed for swift disaster relief, and this did not come at the expense of cutting social expenditures. After *financial crises*, environmental performance deteriorated more in countries with a wide deficit and high debt (figures 3.10C and 3.10D), as tighter financing constraints made environmental protection less of a priority for Governments and firms. However, these results do not always hold.

*Countries with a high debt sometimes prove to be more resilient, if they have better market access to finance their crisis response.* Following *financial crises*, extreme poverty rises only in countries with low sovereign credit ratings (figure 3.10E) regardless of their government debt level. Similarly, following *terms-of-trade shocks*, the unemployment rate rises only in countries with low levels of financial development (figure 3.10F), where tight financing constraints could result in layoffs.

**Figure 3.10**

**Fiscal space matters for recovery, including sovereign credit ratings**



Source: ESCAP.

Note: Countries which score "high" or "low" are based on whether they lie above or below the median. In some cases, the 75th and 25th percentiles are applied.

The size and speed of fiscal response also depend on institutional readiness. In the Asia-Pacific region, discretionary fiscal support was particularly large and sustained against financial crises compared with smaller and shorter-lived interventions against epidemics and natural disasters (figure 3.11). Moreover, the size and speed of fiscal response varied by country, depending not only on its fiscal space but also on factors related to institutional readiness (figure 3.12). Fiscal balance, rather than debt level, seems to be a better predictor of fiscal response. Countries with strong human capital, public services and infrastructure responded faster. Countries with higher social protection spending responded more aggressively, which may reflect not only the existence of automatic stabilizers but also the institution of changes in coverage or benefit levels during a crisis. Fiscal response was also stronger in countries which received adequate foreign aid and in countries with low inflation, where the inflationary effects of fiscal stimulus is less of a concern.

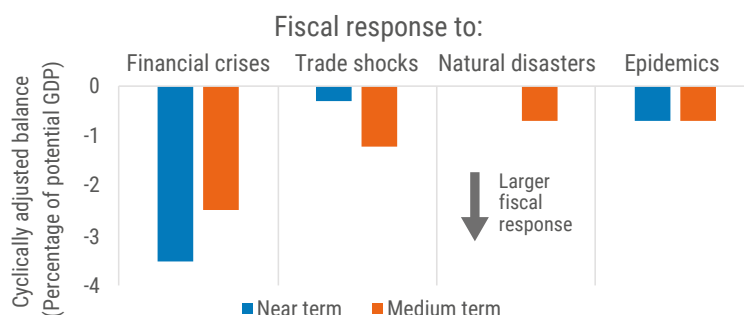
## 4.2. Monetary, financial and external sector policies can mitigate shocks

Expansionary **monetary policy** can be a powerful tool for economic recovery, although the evidence is weaker for developing countries (Cerra, Panizza and Saxena, 2013). A 1 per cent reduction in the real interest rate increases the probability of exiting a recession by 6 per cent (Kannan, Scott and Terrones, 2014).<sup>5</sup>

<sup>5</sup> This refers to a reduction beyond that implied by the Taylor rule, which is a formula that can be used to predict or guide how central banks should alter interest rates due to changes in the economy.

Figure 3.11

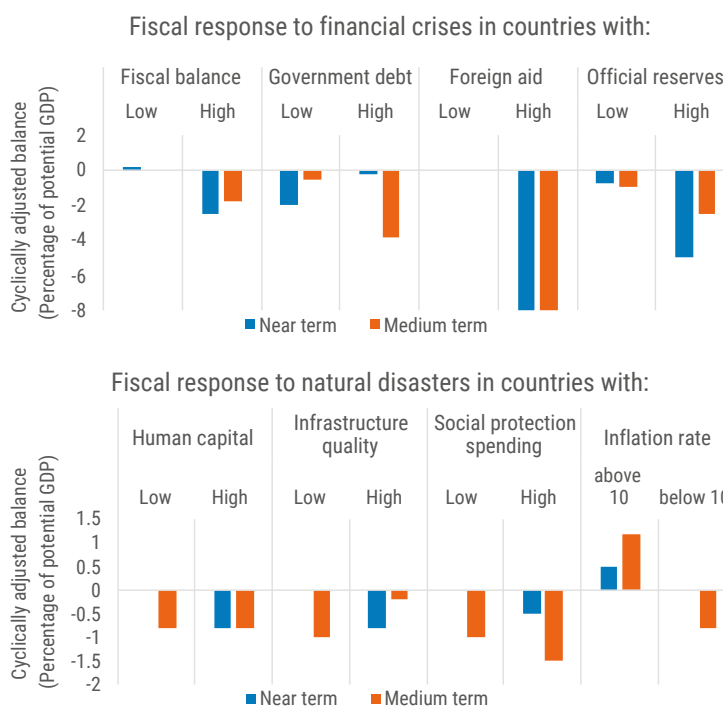
**Fiscal response was stronger against financial crises compared with other shocks**



Source: ESCAP, based on World Bank Fiscal Space Database.

Figure 3.12

**What determines the size and speed of fiscal response?**



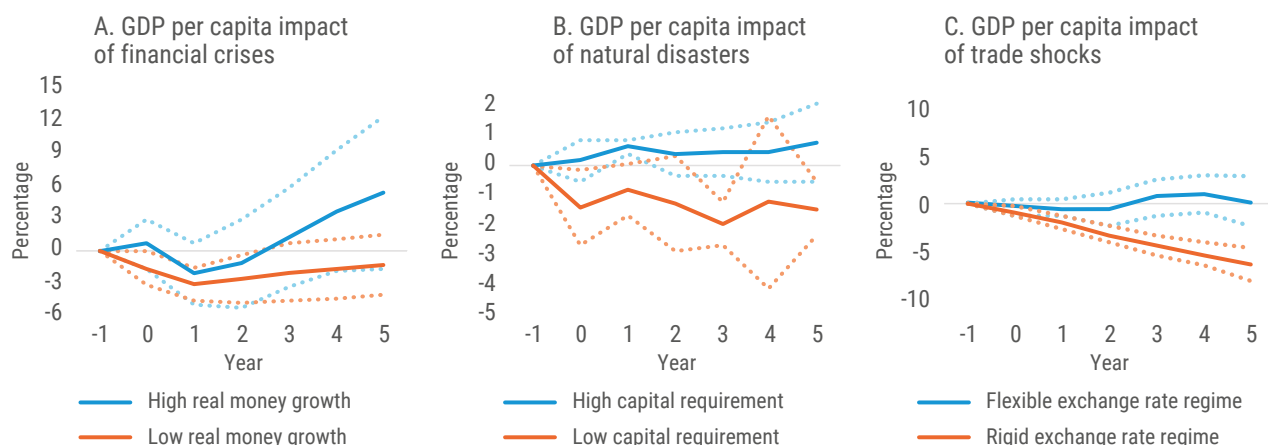
Source: ESCAP.

In contrast, a 1 per cent increase in the interest rate leads to a 2.5 per cent decline in GDP in the long run (Jorda, Singh and Taylor, 2020). At the same time, **macroprudential policies** can mitigate the impact of shocks, partly by allowing for more countercyclical monetary policy response (IMF, 2020c). **External buffers**, such as having adequate official reserves and a flexible exchange rate regime, could also help absorb shocks (Edwards and Yeyati, 2005).



**Figure 3.13**

### How monetary, financial and external sector policies make a difference



Source: ESCAP.

In the Asia-Pacific region, countries with an expansionary monetary policy, as measured by the *change in money supply*, recovered faster from financial crises and natural disasters (figure 3.13). Countries with higher *bank capital requirements*, a macroprudential measure, recovered faster from natural disasters in line with the previous recommendation for higher prudential capital and liquidity ratios in disaster-vulnerable countries (IMF, 2016). However, contrary to what would be expected, this is not so evident for financial crises. This may be because Asia-Pacific countries rely on a wide range of macroprudential measures, such as loan-to-value ratios, and not simply on capital requirements. At the same time, countries with *flexible exchange rate regimes* experienced a milder recession than peers with rigid regimes in the wake of terms-of-trade shocks.

#### 4.3. Remittances and foreign aid tend to respond countercyclically and can support recovery

Remittances alleviate poverty, improve nutritional outcomes, are associated with higher spending on education and reduce child labour in disadvantaged households. Several studies have found that **remittances** are negatively correlated with the business cycle in recipient countries, increasing in response to such events as natural disasters (Ebeke and Combes, 2013) and food price shocks (Combes and others, 2014). Similarly, **development aid** rises steeply when aid-receiving countries experience large adverse shocks, especially in countries with more transparent institutions (Dabla-Norris, Minoiu and Zanna, 2015).

In the Asia-Pacific region, countries with large remittance inflows experienced smaller declines in private consumption after terms-of-trade shocks and smaller increases in extreme poverty after natural disasters (figure 3.14). Similarly, countries with large inflows of official development assistance (ODA) experienced smaller declines in GDP per capita after natural disasters and less disruption in human capital accumulation after terms-of-trade shocks.<sup>6</sup>

#### 4.4. Health and social protection systems can help build resilience from the bottom up

**Pre-crisis vulnerabilities in the form of weak health-care and social protection systems could amplify the impact of shocks.** Healthier people generally have lower mortality and

<sup>6</sup> A turning point in the debate on whether or not aid is good for growth was reached when Clemens, Radelet and Bhavnani (2004) distinguished between humanitarian and non-humanitarian aid. Their argument was that humanitarian aid was not supposed to increase growth. However, it seems to stem the fall in GDP.

morbidity in response to epidemics and weather shocks, such as heat waves. In Fiji, poor households receiving cash assistance in the wake of Tropical Cyclone Winston (the most powerful storm on record in the southern hemisphere) recovered faster than the near-poor who were similarly affected and yet did not qualify for assistance (Mansur, Doyle and Ivaschenko, 2018). *Social protection was a cost-effective stimulus measure for savings jobs during the 2008 global financial crisis* (ILO, 2011). At the same time, labour market policies and institutions can cushion the impact of shocks by influencing the extent to which higher unemployment persists following an initial cyclical increase (Blanchard and Wolfers, 1999).

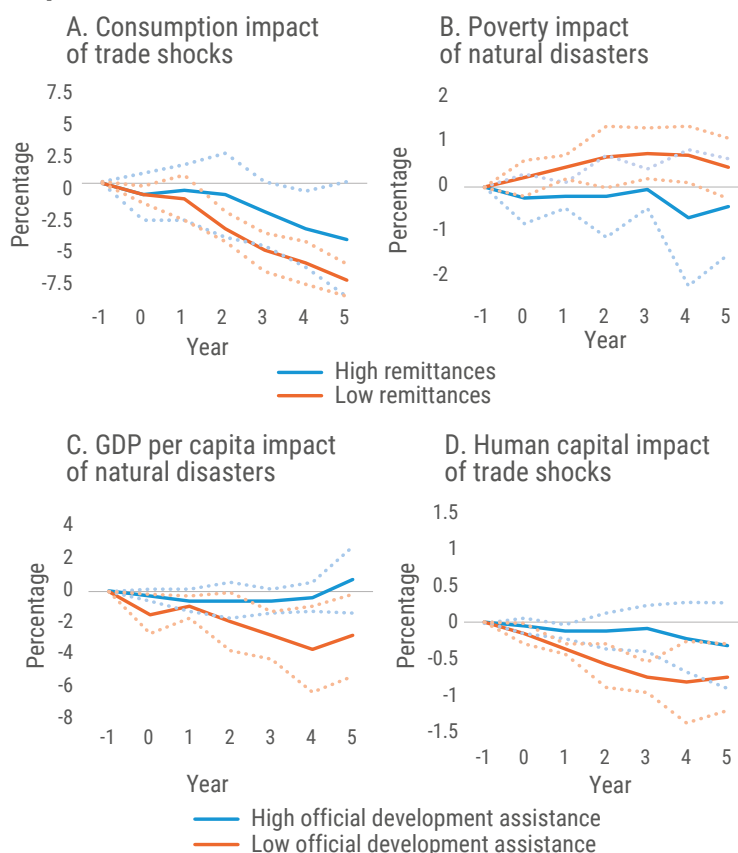
In the Asia-Pacific region, countries with better health-care systems, as proxied by government health expenditures, experienced faster economic recovery (figure 3.15A) and avoided large declines in human capital (figure 3.15B) in the wake of epidemics. Similarly, countries with higher social protection expenditures experienced lower poverty impacts from terms-of-trade shocks (figure 3.15C). The impact on inequality was greater in countries with widespread vulnerable employment (figure 3.15D).

#### 4.5. Infrastructure, economic diversification and institutions are key ingredients which require time and continuous effort

**Several other structural factors are important for resilience to shocks.** Some \$4 trillion could be saved by investing in resilient **infrastructure**, with \$4 in benefit being produced for each \$1 invested in developing

**Figure 3.14**

#### Remittances and foreign aid have direct welfare implications

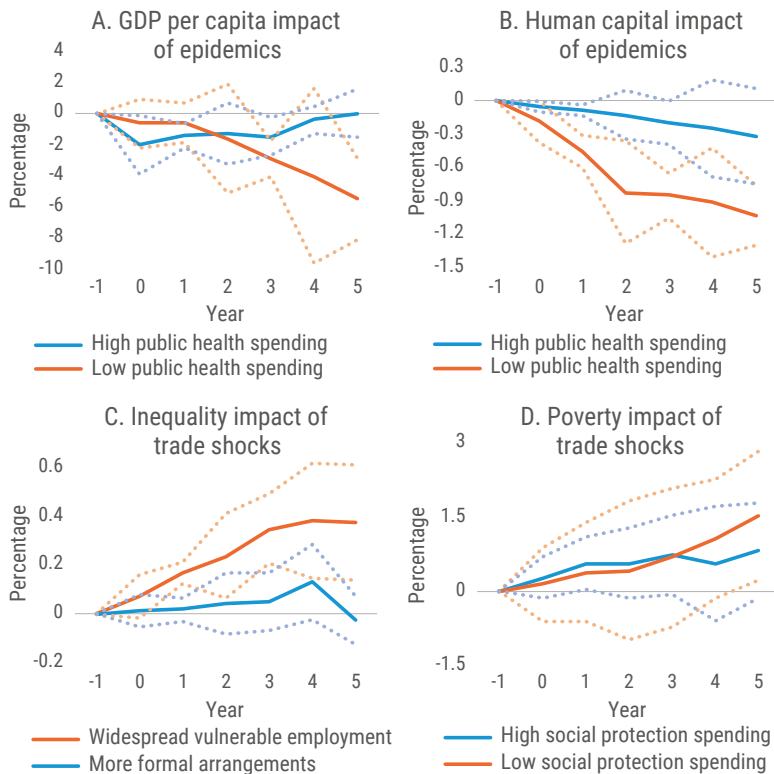


Source: ESCAP.

countries (Hallegatte, Rentschler and Rozenberg, 2019). Natural disasters cause not only direct damage but also wider disruptions for households and firms, and this impact would be larger with low-quality infrastructure. Countries with more diversified economies are typically more resilient. **Economic diversification** increases the ability of countries to adapt to shocks as well as continue functioning in times of crises (UNCTAD, 2020a). Countries with higher productive capacities, as measured by the Economic Complexity Index, experience lower crisis duration (Hausmann, Rodriguez and Wagner, 2006). Fewer barriers to entrepreneurship are associated with lower macroeconomic volatility and smaller output falls during downturns (Ziemann, 2013). High-quality **institutions** enable countries to apply countercyclical monetary and fiscal policies to combat external shocks, but procyclicality is the norm in countries with weak institutions (Calderón, Duncan and Schmidt-Hebbel, 2015). The impact

**Figure 3.15**

**Investing in people is a cost-effective strategy for building resilience**



Source: ESCAP.

of external shocks on economic growth are larger the greater are the latent social conflicts in an economy and the weaker are its institutions of conflict management (Rodrik, 1999).

In the Asia-Pacific region, countries with *high-quality infrastructure* avoided a sharp investment decline after natural disasters (figure 3.16A) and setbacks in human capital accumulation after epidemics (figure 3.16B), possibly because good roads and telecommunications facilitate swift disaster relief. Following natural disasters, countries with *diversified economies* achieved stronger investment performance over the medium term (figure 3.16C) and suffered smaller environmental setbacks (figure 3.16D). Countries which rank high on *voice and accountability* experienced a strong rebound in investment after financial crises (figure 3.16E). Countries which rank high on *political stability* were able to mitigate spillovers from epidemics into the macroeconomy (figure 3.16F).

## 5. Recommendations

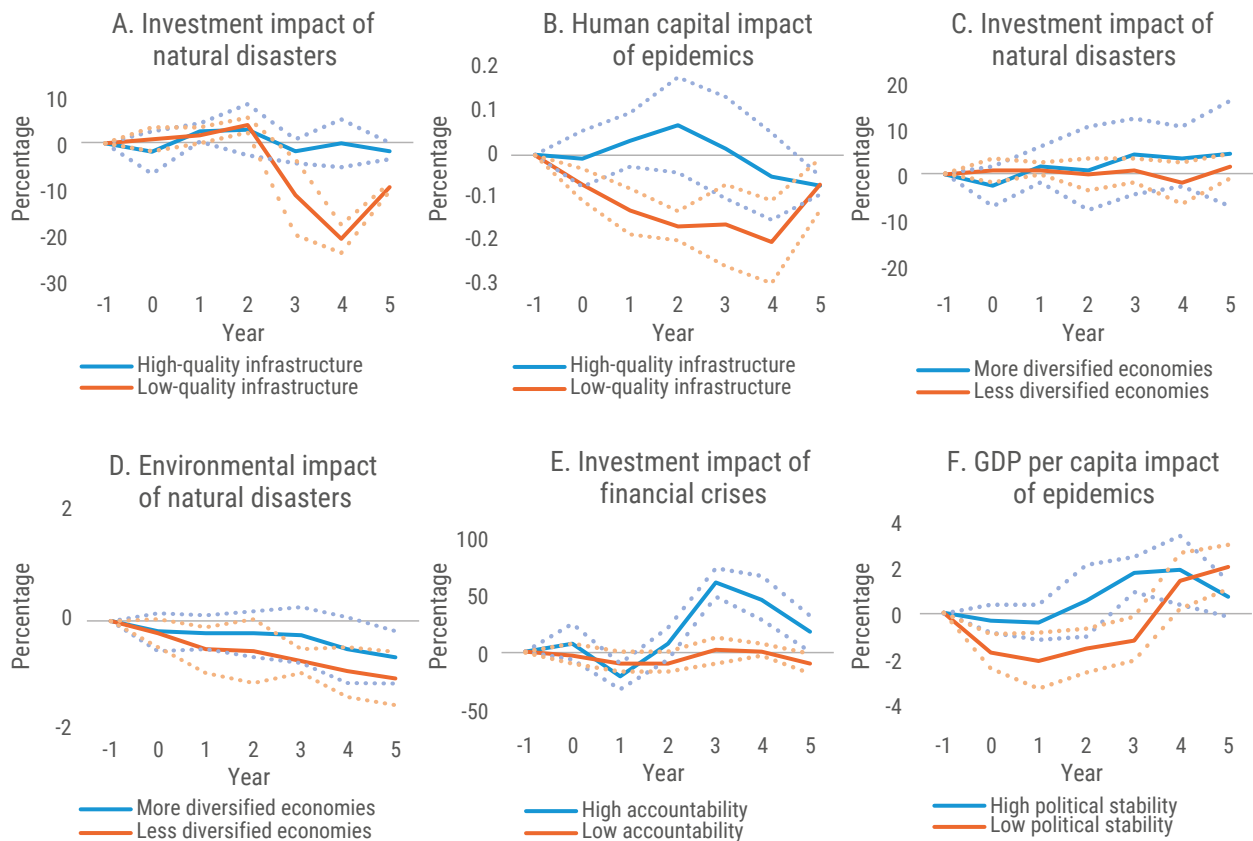
The chapter examined how **policy choices influence the shape of recovery from adverse shocks**. Given the considerable heterogeneity across countries in their level of development, policy frameworks and other characteristics, there is certainly no one-size-fits-all solution. Nevertheless, a cross-country examination, such as this, provides a useful reference for policymakers. Building on the analysis, this section provides three general recommendations.

### 5.1. Respond proactively to minimize setbacks

First, countries should respond aggressively to adverse shocks to minimize the reversal of earlier hard-won gains. Adverse shocks could have large and persistent impacts on economic, social and environmental outcomes, and undo years of progress. **Countries should opt for strong and swift responses rather than end up with “too little, too late”.** As shown during the COVID-19 pandemic, crisis response could require considerable fiscal resources. However, the cost of inaction is much greater. Figure 3.17 illustrates that supportive policies, such as countercyclical fiscal stimulus, could make considerable differences. In the medium term, policy interventions could result in a significant boost in average incomes, human capital and especially environmental performance. *Achieving the Sustainable Development Goals will require actions not only to accelerate progress but also to minimize setbacks from adverse shocks.*

**Figure 3.16**

**Structural factors determine the economic impact but also social and environmental impacts**

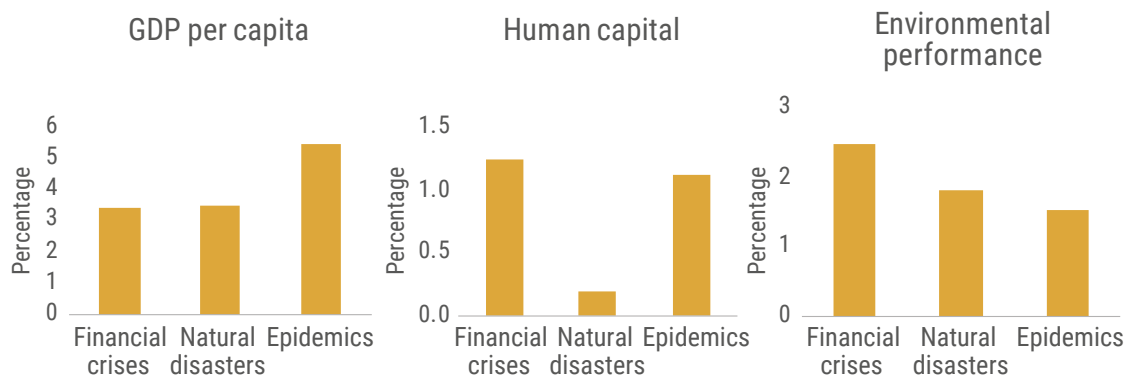


Source: ESCAP.

**Figure 3.17**

**Safeguarding sustainable development in times of crisis**

(Potential boost estimated by the difference in five-year cumulative impact between countries with and without supportive policies)



Source: ESCAP.

Given that crises often have persistent impacts, policymakers need to decide not only on the scale of the initial response but also on when and how supportive measures will be phased out. While this would require prudent consideration of various factors, *it is important that a rebound in GDP growth rates is not mistaken for recovery*. Moreover, fiscal multipliers are larger during periods of slack, and therefore **abrupt consolidation could prolong a crisis**. Another aspect to consider is that, while countries could redeploy existing budgets towards immediate crisis relief, if this entails cutting down on development spending, even if only temporarily, there may be little net gain in sustainable development. This is particularly the case in developing countries, where Sustainable Development Goal-related spending is already quite low (Lee and others, 2020). Insurance and emergency financing mechanisms will therefore be important (see chapter 5). Finally, given that the ability to deploy a strong response to shocks and sustain it as necessary depends on a country's fiscal space, countries will need to expand that space during good times through *expenditure reprioritization, revenue reforms, capital market development and effective public debt management* (Lee, 2020). As will be shown in chapter 4, phasing out of fossil fuel subsidies and implementing carbon taxes could provide fiscal space in addition to producing environmental benefits.

## 5.2. Incorporate risk management into development planning and policymaking

Second, risk management should become part and parcel of development planning and policymaking. **Policymakers need to assess the nature of the risks their country faces, and the available pre- and post-crisis policy options**. Figure 3.18 illustrates that some shocks have more persistent or wide-ranging impacts than others, calling for continuous interventions or coordination among stakeholders. The appropriate response would vary depending on the nature of the risk. Previous studies have generally argued for stronger emphasis on short-term post-disaster rehabilitation for natural disasters and on long-term continuous interventions against economic crises (Sawada, Bhattacharyay and Kotera, 2011). However, the present chapter has shown that “non-economic” shocks could also have persistent economic, social, and environmental impacts. Figure 3.18 further illustrates that countries need both crisis-prevention strategies and coping strategies. Pre-crisis policy choices can reduce the likelihood of a crisis, such as macroprudential measures for banking crises, and reduce the loss when a crisis occurs, such as early warning systems and climate-resilient infrastructure

for natural disasters. Incorporating risk management into developing planning and policymaking also entails cost-effective insurance and emergency financing mechanisms, as will be discussed in chapter 5.

In going forward, **institutional reforms will be needed to mainstream risk management and to achieve better coordination among stakeholders**. Government planning should factor in uncertainty through assessment of alternative scenarios and be supported by *multi-stakeholder risk assessment frameworks*. Singapore's “Whole-of-Government Integrated Risk Management” framework is an example of an approach that has overcome “silos” within the Government. Its Strategy Committee is composed of permanent secretaries from various ministries. This multi-risk framework is complemented by agencies focused on specific risks. Similarly, a national risk board consisting of policymakers and independent experts could be established with the power to issue “act-or-explain” recommendations to relevant authorities responsible for implementing policy (World Bank, 2014). The board's composition and powers should strive to achieve an adequate balance of expertise, credibility, relevance and legitimacy.

## 5.3. Enhance international assistance towards least developed countries

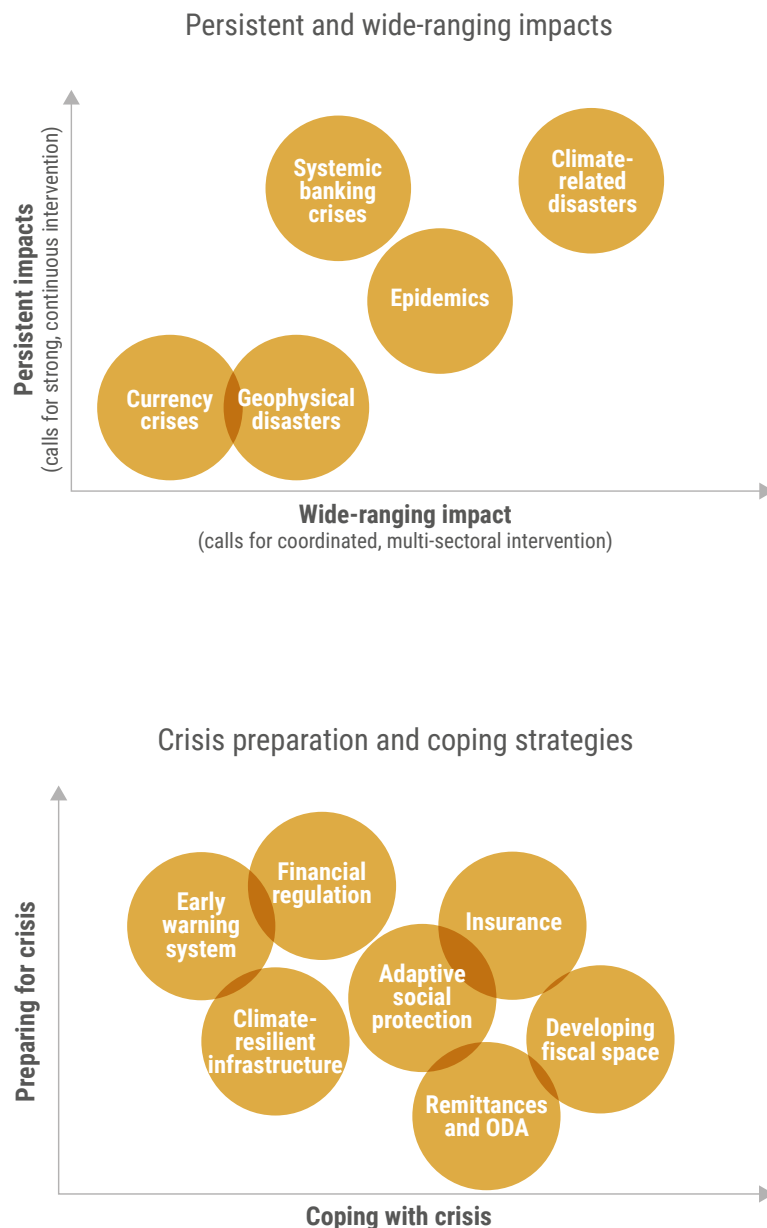
Third, least developed countries and small island developing States will require enhanced international assistance. While the present chapter has highlighted the importance of policy choices and structural factors in enhancing resilience, these countries

fall behind on almost all these measures compared with regional peers and advanced economies. For the Asia-Pacific region, figure 3.19 shows that **least developed countries face a significant “resilience gap”** in the form of limited market access for sovereign borrowing, shortcomings in the macroeconomic policy framework, low social protection expenditures, poor quality of infrastructure and low levels of economic diversification and productive capacity.

While the international community has recognized for some time the need for providing these countries with strong and tailored support, actual implementation has been weak, as reflected in ODA. There is a long-standing commitment by developed countries to provide the equivalent of 0.15 to 0.20 per cent of their gross national income (GNI) in the form of ODA to least developed countries. However, in 2017, only 7 of the 29 countries then in the OECD Development Assistance Committee fulfilled this commitment. Had all donors honoured their pledge, least developed countries would have received additional funding ranging from \$33 billion to \$58 billion in 2017 (UNCTAD, 2019c). These resources are urgently needed to implement resilience-enhancing actions in the most vulnerable countries, as discussed in depth in UN-OHRLLS (2018) and the forthcoming ESCAP publication, entitled *Asia-Pacific Countries with Special Needs Development Report 2021*.

**Figure 3.18**

### Preparing for future crises through integrated risk management



Source: ESCAP.



**Figure 3.19**  
**The “resilience gap” of least developed countries**



Source: ESCAP.

Note: “Other developing countries” excludes least developed countries, landlocked developing countries and small island developing States. For the selected indicators, a higher score is associate with greater resilience to shocks.

## 6. Conclusions

Even before the COVID-19 pandemic, the Asia-Pacific region was not on track to achieve the Sustainable Development Goals (ESCAP, 2020d) due to a development paradigm which relied on short-term solutions to boost economic growth at the cost of societal inequalities, growing pressure on natural resources and ecosystems, and climate change (ESCAP, 2020a). This approach, which dominates the formulation of economic policies, contributed to a wide deficit in investments towards ending poverty and hunger, enhancing education, health and social protection, increasing access to enabling infrastructure and protecting the planet (ESCAP, 2019b). **From a resilience perspective, such a deficit in long-term investments meant heightened vulnerability to**

**adverse shocks.** If there is one lesson to be learned from past crises, it is that pre-existing vulnerabilities can amplify shocks and make recovery more difficult. Therefore, the next chapter proposes a “building forward better” package of policy reforms and long-term investments aimed at building resilience. Given that adverse shocks reverse hard-won gains across the three dimensions of sustainable development, it is argued that such a package too should be comprehensive in nature.



# Chapter 4

## Building Forward Better: Policy Scenarios

### 1. Introduction

As emphasized in chapter 2, the COVID-19 pandemic has disrupted economic activities in Asia and the Pacific at an unprecedented scale, and any recovery remains tentative. As countries prioritize speedy economic recovery, the pandemic is likely to intensify the trend of excessive focus on promoting economic growth, and little attention will be paid to improving social and environmental conditions in the Asia-Pacific region. At the same time, chapter 3 revealed that past episodes of adverse economic and non-economic shocks have reversed development gains that took decades to accomplish. Countries that were equipped with stronger social and physical infrastructure and those that managed to respond more swiftly and forcefully suffered less from those shocks.

Against this background, **this chapter seeks to address two key policy questions.** *First*, how can the Asia-Pacific region design a coherent policy package that helps countries to build forward better? Such a package envisages a future that is both more resilient to shocks and more in line with the ambitions of the 2030 Agenda for Sustainable Development. *Second*, what would be the key implications of this package, both in terms of its potential benefits on social and environmental outcomes and the possible fiscal pressure that this package could create?

**This chapter contains three main findings.** *First*, worryingly, there remains considerable room to integrate social and environmental considerations into how the region reacts to the COVID-19 pandemic. *Second*, the simulation analysis, based on a newly developed macroeconomic model for Asia and the Pacific, demonstrates that a policy package to build



forward better would help reduce poverty and income inequality, cut carbon emissions and improve air quality to a notable extent in the long run. *Third*, given the large fiscal needs to build forward better and combat the pandemic, debt vulnerability would rise steeply in the region's less developed economies.

### **These findings involve some important policy implications.**

*First*, contrary to doubts among some policymakers and analysts, this chapter provides quantitative evidence that green development is good for economic growth. Asia-Pacific economies that have not fully integrated climate and clean energy actions into their COVID-19 policy responses should actively do so. *Second*, to meet large fiscal needs and avoid public debt distress, Asia-Pacific countries need to step up their effort in exploring untapped sources of financial resources. This is the area that the next chapter will examine in greater detail.

The chapter begins by assessing the extent to which the COVID-19 policy responses introduced by Asia-Pacific countries help them to secure more inclusive and greener development (section 2). To provide a glimpse into how to build forward better, section 3 proposes an illustrative policy package that is aimed at providing basic social services, closing the digital divide and strengthening climate and energy actions. Section 4 examines public debt sustainability under different scenarios and stress tests. The chapter ends with conclusions in section 5.

## **2. COVID-19 policy responses in Asia and the Pacific: considerable room remains to build forward better**

**Amid unprecedented policy responses to the pandemic, an important consideration is whether these responses help countries to build forward better.** As highlighted in chapter 2, the size of fiscal stimulus in developing Asia-Pacific countries amounted to \$1.8 trillion, or about 6.6 per cent of GDP. In going forward, Asia-Pacific countries should ensure that their policy responses to the pandemic place them in a better position to move forward towards implementing the 2030 Agenda for Sustainable Development. That is, policy packages should be aimed at helping countries not only to swiftly regain economic strength but also support inclusive and green development. For example, fiscal stimulus that emphasizes renewable energy over fossil fuels would generate more jobs and foster greener recovery through decarbonization. One good example in this context is the Korean New Deal, which is aimed at transforming the Republic of Korea into a smart, green and safe country (Government of the Republic of Korea, 2020).

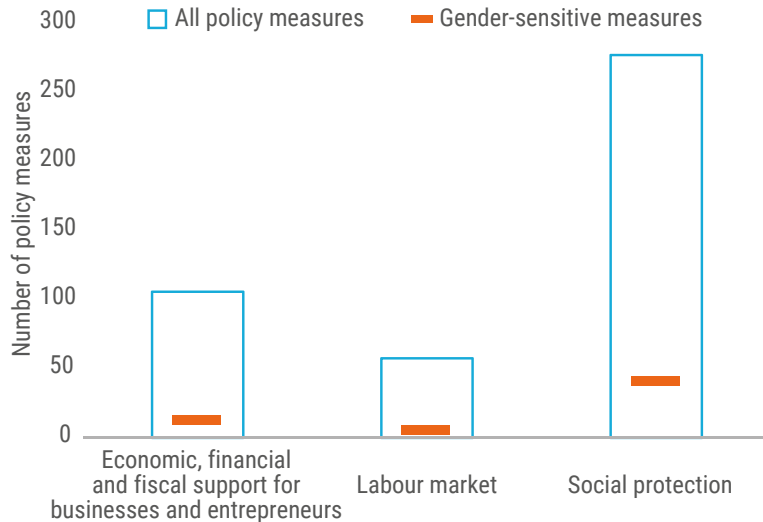
This section provides a snapshot of assessments on the extent to which the COVID-19 policy responses introduced by Asia-Pacific countries will help them achieve social inclusiveness and green development in going forward. Selected policy measures are summarized in annex III. Overall, it is argued that, while some countries are leading such efforts, the Asia-Pacific region as a whole needs to step them up.

### **2.1. Inclusive development: inadequate response to enhancing gender equality**

**The socioeconomic policy responses in Asia and the Pacific demonstrated inadequate focus on gender equality.** Of the 441 policy measures introduced along the economic, social protection and labour market dimensions, only 57 of them can be defined as gender-sensitive (figure 4.1). For instance, social protection and labour market measures are gender-sensitive if they benefit women's economic security amid notable job and income losses or address the unprecedented increase in unpaid care work. Gender-sensitive economic measures are those that provide female-dominated business sectors with support. For most countries, policies aimed at strengthening women's economic security are more common than those addressing unpaid care (figure 4.2).

**Figure 4.1**

**COVID-19 policy measures that promote gender equality are uncommon**



Source: ESCAP, based on UNDP-UNW COVID-19 Global Gender Response Tracker.

Note: The fourth category of policy measures captured in this database on policies to address violence against women are gender-sensitive by default.

**Figure 4.2**

**Policies to support unpaid care are lacking in many Asia-Pacific economies**



Source: ESCAP, based on UNDP-UNW COVID-19 Global Gender Response Tracker.

**2.2. Green development: responses fall short of expectations**

An early assessment reveals that policy responses have missed the opportunity – as had been the case during the 2008 global financial crisis – to promote green development. Announced fiscal stimulus in all 10 Asia-Pacific countries covered in a recent study tended to have a net negative impact on climate change, biodiversity and air quality (Vivid Economics, 2020). This is because the volume of financial flows to carbon-intensive sectors, such as agriculture, industry, energy and transport, exceeds the flows that benefit the environment. Encouragingly, investing in green infrastructure is a rather common policy measure in selected Asia-Pacific economies (figure 4.3A), although they also often provided subsidies, waived fees or reduced taxes for environmentally harmful activities, such as coal exploration (figure 4.3B). Moreover, several countries deregulated environmental standards and gave financial bailouts without in return requiring limits on carbon emissions. Finally, programmes to protect biodiversity are hardly part of the fiscal stimulus.

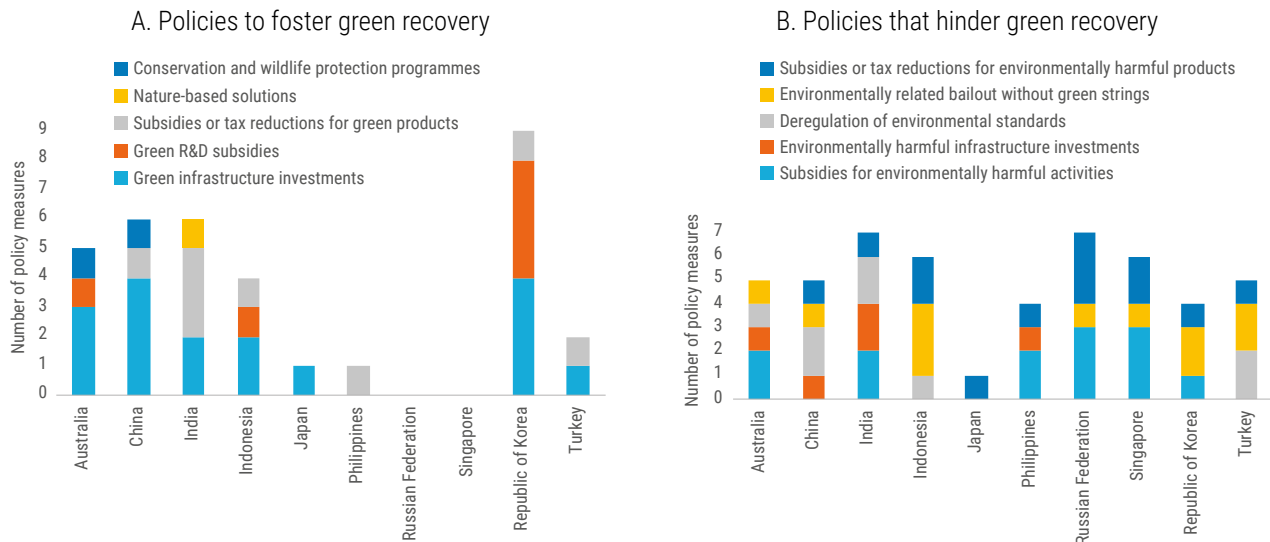
**In the area of energy, much of the committed fiscal funds are directed to fossil fuels that are harmful to the environment.** Since the pandemic began, about \$108 billion has been approved to support energy production and consumption in various sectors in the 10 Asia-Pacific countries.<sup>1</sup> The majority or the entire amount of these funds is being channelled to fossil fuels without any

<sup>1</sup> For details, see the Energy Policy Tracker Database ([www.energypolicytracker.org/](http://www.energypolicytracker.org/)).



**Figure 4.3**

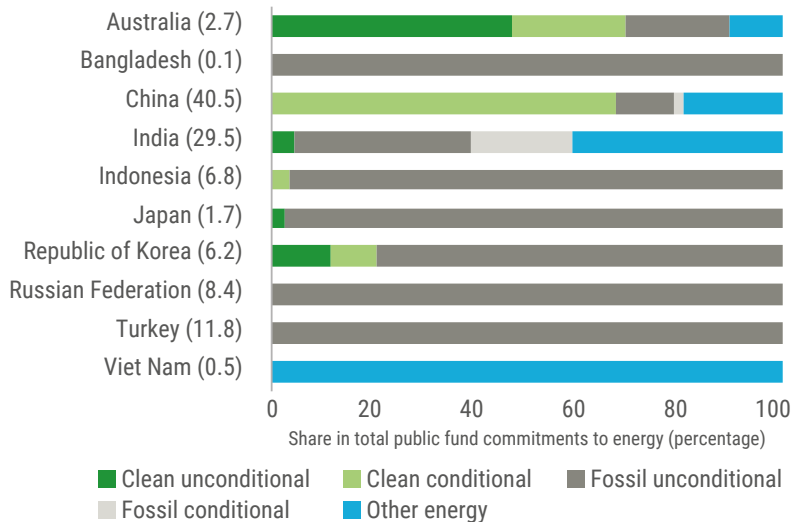
**Policy measures in major Asia-Pacific countries are hindering green development**



Source: ESCAP, based on Vivid Economics (2020).

**Figure 4.4**

**A large part of public funds is committed to environmentally harmful energy sources**



Source: ESCAP, based on Energy Policy Tracker.

Note: Numbers in parentheses show the amount in billions of United States dollars of public fund commitments to all types of energy.

climate targets or pollution-reduction requirements ("fossil unconditional") (figure 4.4). In China, about two thirds of the committed funds support the

transition away from fossil fuels, but the implementation of environmental safeguards is less clear ("clean conditional"). On the other hand, close to half of the approved funds in Australia promote energy efficiency and renewable energy from natural sources ("clean unconditional").



### 3. Policy scenarios to build forward better: sizable socioeconomic and environmental benefits

Section 2 suggests that there is considerable room for the Asia-Pacific region to further integrate social and environmental issues into their COVID-19 policy responses. In this regard, this section proposes an illustrative policy package that can help enhance countries' ability to withstand future shocks and achieve more inclusive and greener development. Based on model simulations, implementing such a policy package would help raise economy-wide productivity, reduce poverty and income inequality, cut carbon emissions and improve air quality. In other words, the proposed package would help the region to "build forward better".

The building forward better policy package comprises three sub-packages<sup>2</sup>:

- The *social services* package is intended to provide universal access to health-care services and social protection floor. It assumes increases in countries' spending in these two areas;
- The *digital access* package is aimed at closing the digital divide. The package assumes spending hikes in ICT and education;
- The *green development* package is intended to strengthen climate and energy actions. The package assumes larger spending on energy access and efficiency, climate-resilient infrastructure and biodiversity preservation, as well as introduction of a carbon tax and elimination of fuel price subsidies.

Box 4.1 provides brief details on the macroeconomic model used in this chapter, as well as key technical assumptions that are made for model simulations.

**Delivering the social services package will help reduce poverty and income inequality in Asia and the Pacific.** This package affects socioeconomic variables through several channels (figure 4.5). As expected, an increase in health expenditure helps lift labour productivity, which translates

#### Box 4.1

##### The macroeconomic model and key assumptions

The quantitative analysis in this chapter is based on a new macroeconomic model for Asia and the Pacific developed by ESCAP. In the model, each country's GDP is driven by its short-run aggregate demand. In the long term, the potential output level depends on labour force, capital stock, energy demand and productivity growth. The model also captures interactions among social, economic and environmental variables. It contains 46 individual Asia-Pacific country models and other blocs that represent other major global economies. The individual country models are linked together via trade, remittances, financial markets and energy markets. Annex IV provides more information on the model structure.

A country's spending hike is underpinned by increases in government consumption, government investment and private investment. The exact composition varies across spending areas. For example, to provide universal access to education, it is assumed that 65 per cent of the total spending increase comes from public consumption (e.g. education personnel), 20 per cent from public investment (e.g. improving Internet connections in rural schools) and 15 per cent from private investment. The contribution from

<sup>2</sup> In addition to these policy areas, the COVID-19 pandemic also reveals several other areas that Asia-Pacific countries should consider while building forward better. Examples include broadening the economic base; making shifts in supply chains (e.g. reshoring production of essential goods); ensuring comprehensive vital statistics (e.g. timely cash transfers to vulnerable groups); and fostering stronger regional cooperation to address cross-boundary emergencies. Some of these aspects on building economic resilience are discussed in chapter 3.

private investment is assumed to be larger for development areas that are more commercially viable. For example, private investment and public investment account for 60 and 40 per cent of total ICT investment, respectively.

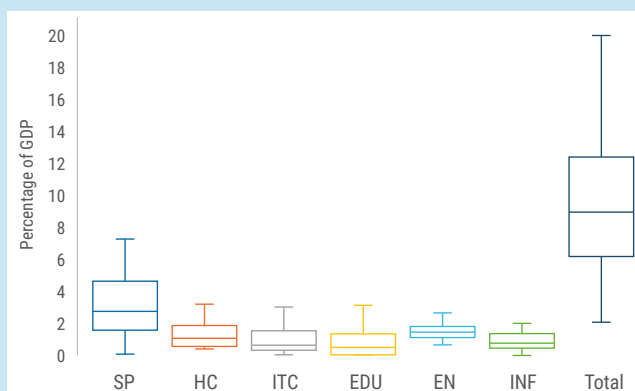
Regarding the time period and length of policy interventions, it is assumed that spending packages last for 10 years starting from the year 2021, so that the end-period is synchronized with the time frame of the 2030 Agenda for Sustainable Development. In general, spending increases are frontloaded, that is, assumed to be larger in earlier years. After this 10-year period, while impetus to public consumption remains, increases to investment are partially withdrawn so that the capital stock accumulated over 10 years is maintained after adjusting for capital depreciation.

We propose two scenarios with different spending levels: one with an “ambitious” spending level, where the magnitude of the spending increase is assumed to match additional investment needs in different Sustainable Development Goal areas, as estimated in ESCAP (2019b). The figure below depicts the cross-country distribution of spending hikes in different investment areas. The other scenario with a “business-as-usual” spending level, where the magnitude of spending increases is assumed to be at a certain proportion of their additional investment needs for attaining the Goals (i.e. the “ambitious” spending level) based

on each country’s past trend of financial resources. On average, available data from 41 developing Asia-Pacific countries suggest that the business-as-usual spending level stands at about 38 per cent of their additional investment needs. Annex V provides more details on this back-of-the-envelope calculation.

### Figure

#### Distribution of spending increases assumed across different investment areas

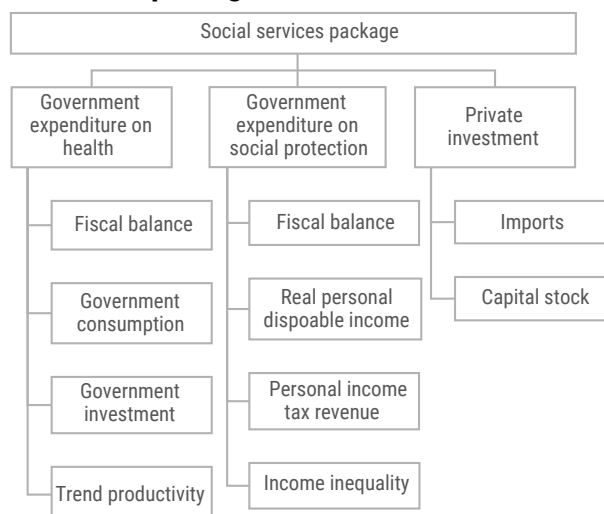


Source: ESCAP (2019b).

Note: The upper and lower limits of the enclosed box correspond to the 75th and 25th percentiles, respectively. The horizontal line within the box depicts the median. The vertical line shows the range with the uppermost (lowermost) point reflecting the maximum (minimum) values. Areas of spending include social protection (SP), health care (HC), information and communications technology (ICT), education (EDU), energy (EN) and climate-resilient infrastructure (INF). The cost to protect biodiversity, which is the same for all countries, is not depicted separately but included in the “total” box.

### Figure 4.5

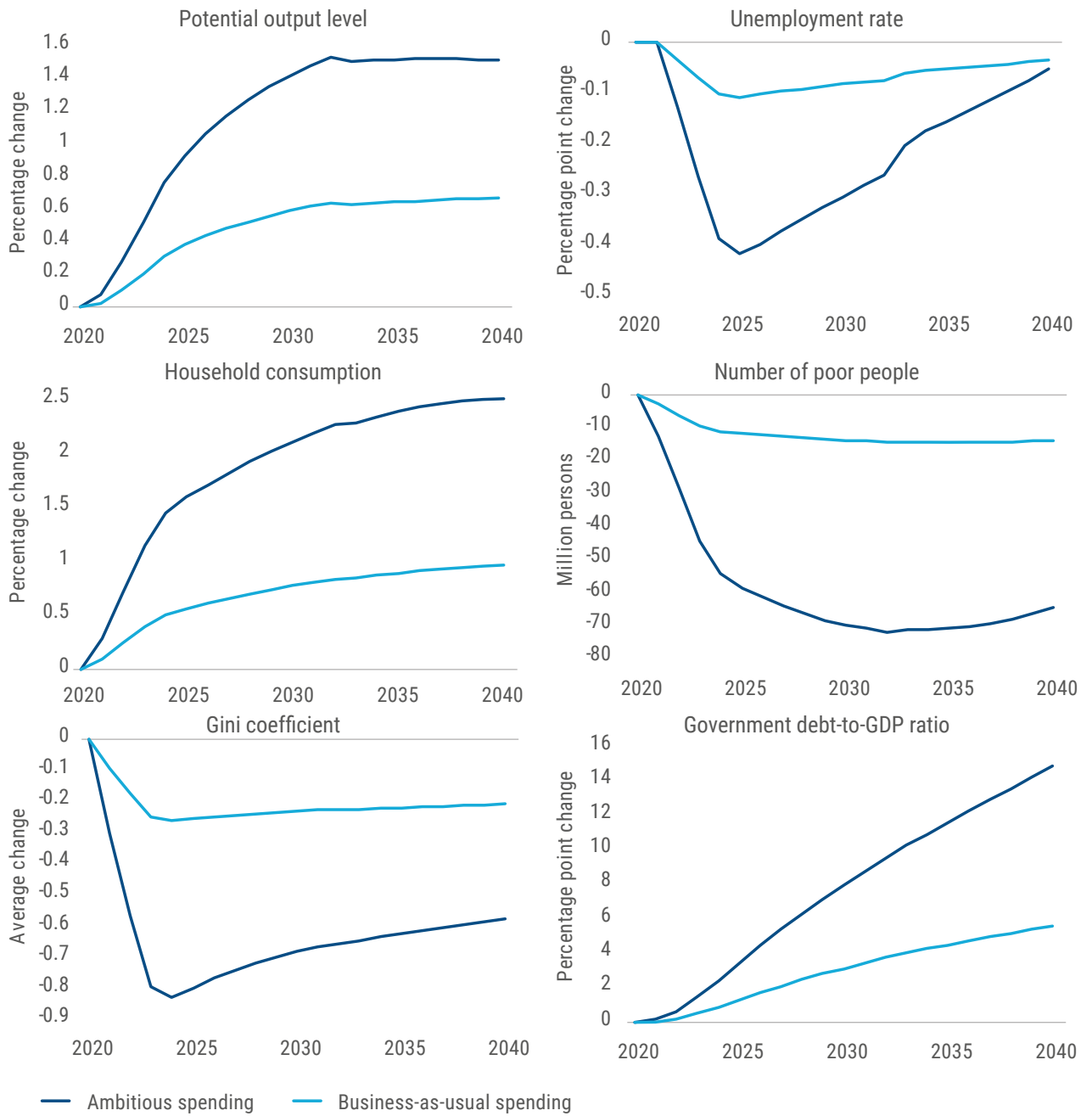
#### Social services package: illustrative channels of impacts



Source: ESCAP.

**Figure 4.6**

**The social services package reduces poverty and income inequality**



Source: ESCAP.

into higher GDP and potential output levels, lower unemployment and higher real personal disposable income (figure 4.6). Under the *ambitious* spending level scenario, the potential output level could be up to 1.5 per cent above the baseline in the long term. Driven by the decline in income inequality and higher household consumption amid stronger social protection floor, the number of poor could fall by about 70 million people when measured at \$5.50 per day. Under the *business-as-usual* spending level scenario, the estimated impact on poverty reduction is much smaller at 14 million people. Finally, despite its notable positive impacts, implementing the social services package could push up the government debt-to-GDP ratio by up to 15 percentage points in the long run.

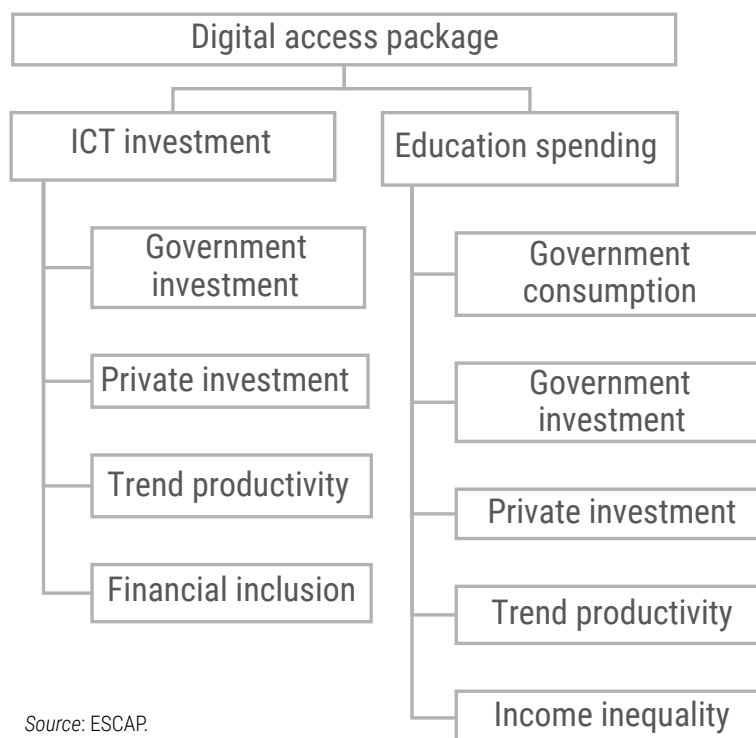
### The digital access package also improves social outcomes notably.

Among other channels (figure 4.7), an increase in ICT investment raises economy-wide productivity, which in turn pushes up potential output and personal income. Higher ICT investment also helps improve access to finance through greater use of online financial services. Together with higher educational attainment, better access to finance helps raise household consumption by reducing liquidity constraints and inequality. Finally, reduced inequality, lower unemployment and higher household income lead to lower poverty.

In terms of the magnitude of impacts, the potential output gain under the digital access package (close to 4.5 per cent above the baseline, figure 4.8) is much larger than that of the social services package due to more

**Figure 4.7**

### Digital access package: illustrative channels of impacts



Source: ESCAP.

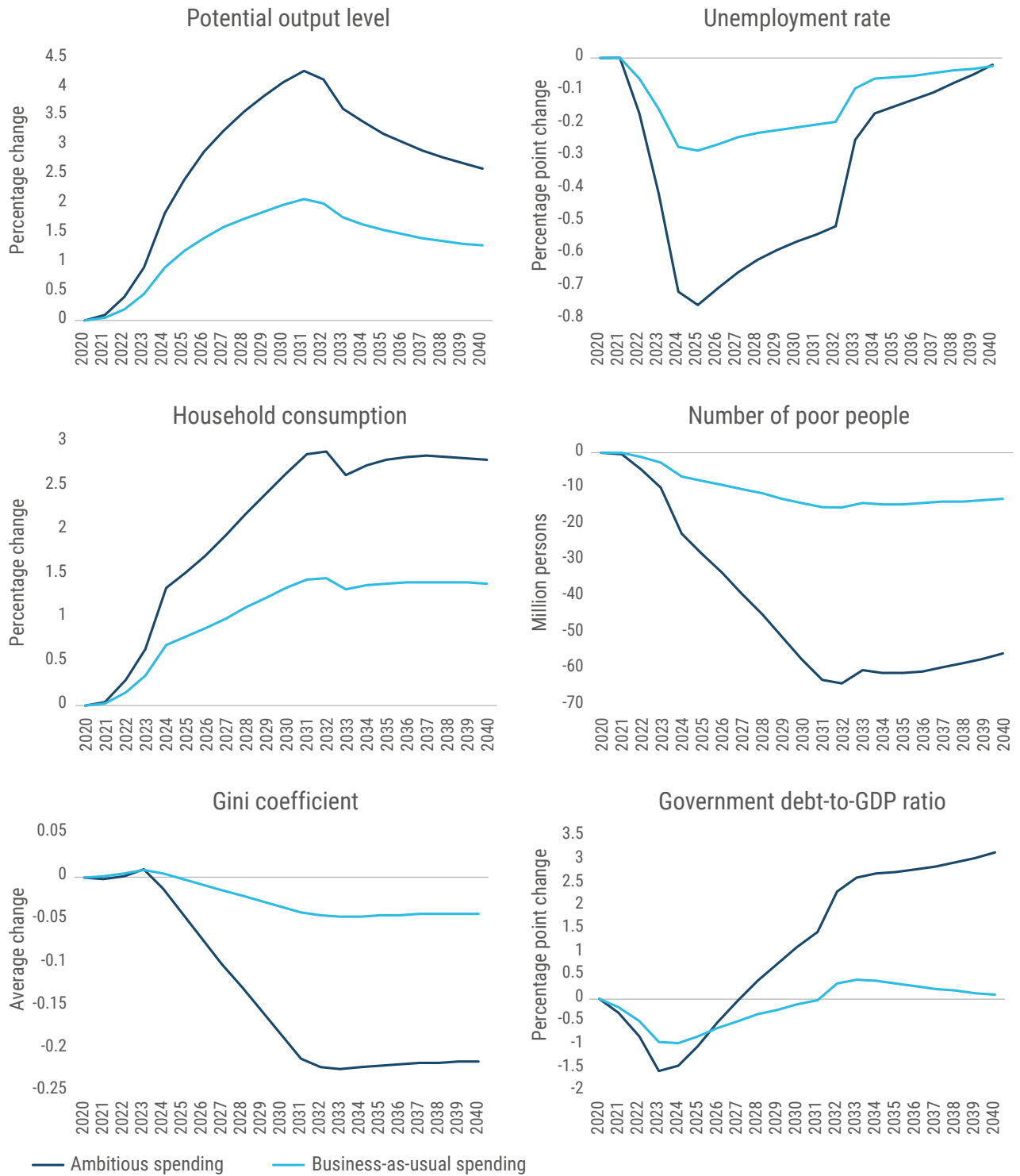
favourable productivity enhancement. Nonetheless, its impact on income inequality and poverty (about 65 million fewer poor persons) is more comparable as spending under the social services package disproportionately benefits the poor. Meanwhile, the government debt-to-GDP ratio is estimated to decrease in the initial years before picking up afterwards. This stems from the assumption that a significant share of investment in ICT is undertaken by the private sector. In the long run, the government debt ratio would be only about 3.5 percentage points above the baseline. Compared with the social services package, the digital access package puts less pressure on public debt burden because its output gains are larger while the share of public spending in total spending is also smaller.<sup>3</sup>

**Not surprisingly, the green development package is estimated to produce sizeable environmental benefits.** The package comprises larger spending on energy access and efficiency, climate-resilient infrastructure and biodiversity preservation, as well as introducing a carbon tax (at \$40 per

<sup>3</sup> In this analysis, greater engagement by the private sector not only helps save fiscal spending, but also contributes positively to the fiscal balance through higher government revenue.

**Figure 4.8**

**The digital access package also improves socioeconomic outcomes**



Source: ESCAP.

## Box 4.2

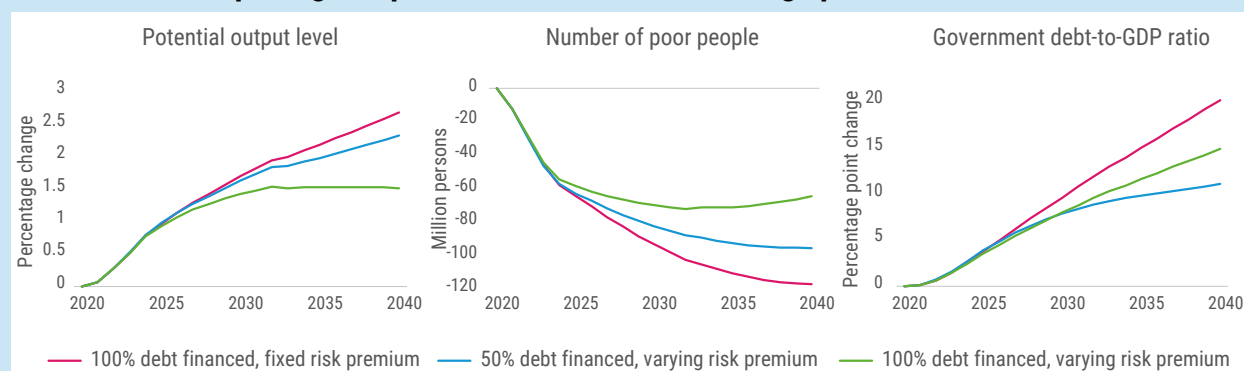
### Do financing options matter?

The simulations assume that increased fiscal spending is entirely financed by an increase in government debt, and that sovereign risk premiums on borrowing rise as the government debt-to-GDP ratio increases. Among other impacts, higher risk premiums will constrain investment (thus limiting potential output and employment) and push up inflation (thus lowering real personal disposable income). Additionally, we carried out two alternative scenarios. *First*, public spending increases remain entirely debt financed, but the risk premiums are fixed. *Second*, only half of public spending increases are debt financed, while the other half is financed through upward adjustments in personal and corporate income tax rates.

As expected, the largest potential output gains among the three scenarios come from having a fixed risk premium (2.7 per cent above the baseline), followed by 50 per cent debt financing and the rest with tax increases (2.3 per cent) and then the main financing assumption of debt financing with varying risk premiums (1.5 per cent). The magnitude of poverty reduction mirrors these potential output gains, with close to 120 million fewer poor people under the fixed risk premium scenario, about 95 million fewer people under the 50 per cent debt financed scenario and about 70 million fewer people under the main financing assumption. Finally, the upward adjustment in the government debt-to-GDP ratio is more modest under the 50 per cent debt financed scenario, as part of the increased fiscal burden is borne by tax increases rather than incurring new debt.

## Figure

### Social services package: impacts across different financing options



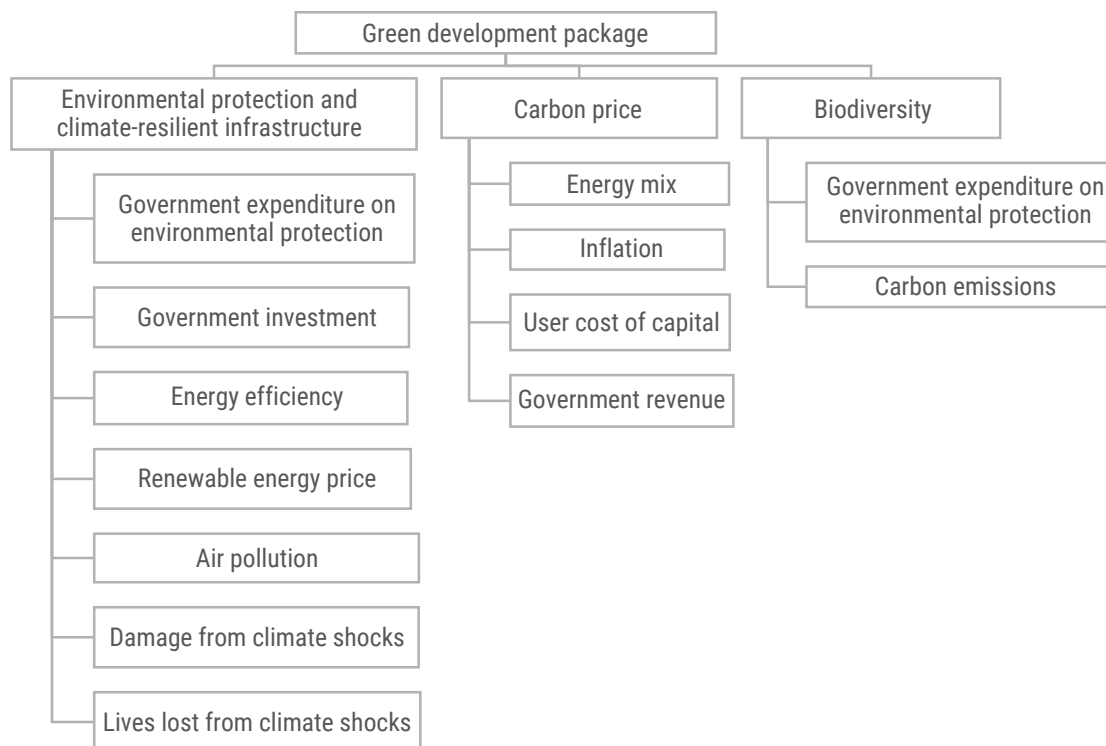
Source: ESCAP.

metric ton) and abolishing fuel price subsidies, with varying channels of impacts (figure 4.9). The most notable results include:

- *First*, a fall in carbon emissions by more than 30 per cent under the *ambitious* spending level scenario (figure 4.10), driven by
- such factors as a higher share of renewable energy in the energy mix amid cheaper renewable energy prices, greater energy efficiency and a decline in total energy use;
- *Second*, a notable improvement in air quality, underpinned by greater use of clean energy and clean cooking and the shift in the energy mix away from coal and oil;
- *Third*, about 6 per cent gain in the potential output compared with the baseline, which is larger than those



Figure 4.9

**Green development package: illustrative channels of impacts**

Source: ESCAP.

under the social services and digital access packages. Contributing factors include energy efficiency gains, lower carbon emissions (thus slowing climate change and lower capital depreciation rate), less damage to the infrastructure from climate shocks (more than 30 per cent lower), fewer lives lost from climate shocks (close to 5 per cent lower) and greater labour productivity amid better air quality and a healthier population. These positive effects more than offset the negative effect of shrinking energy demand due to a newly introduced carbon tax that pushes up energy prices and the user cost of capital;

- *Fourth*, a cut in the public debt ratio by about 5 percentage points due to cancellation of fuel subsidies, carbon tax revenue and stronger economic growth. This is in contrast to social and digital packages where the public debt-to-GDP ratio is estimated to rise in the long term.

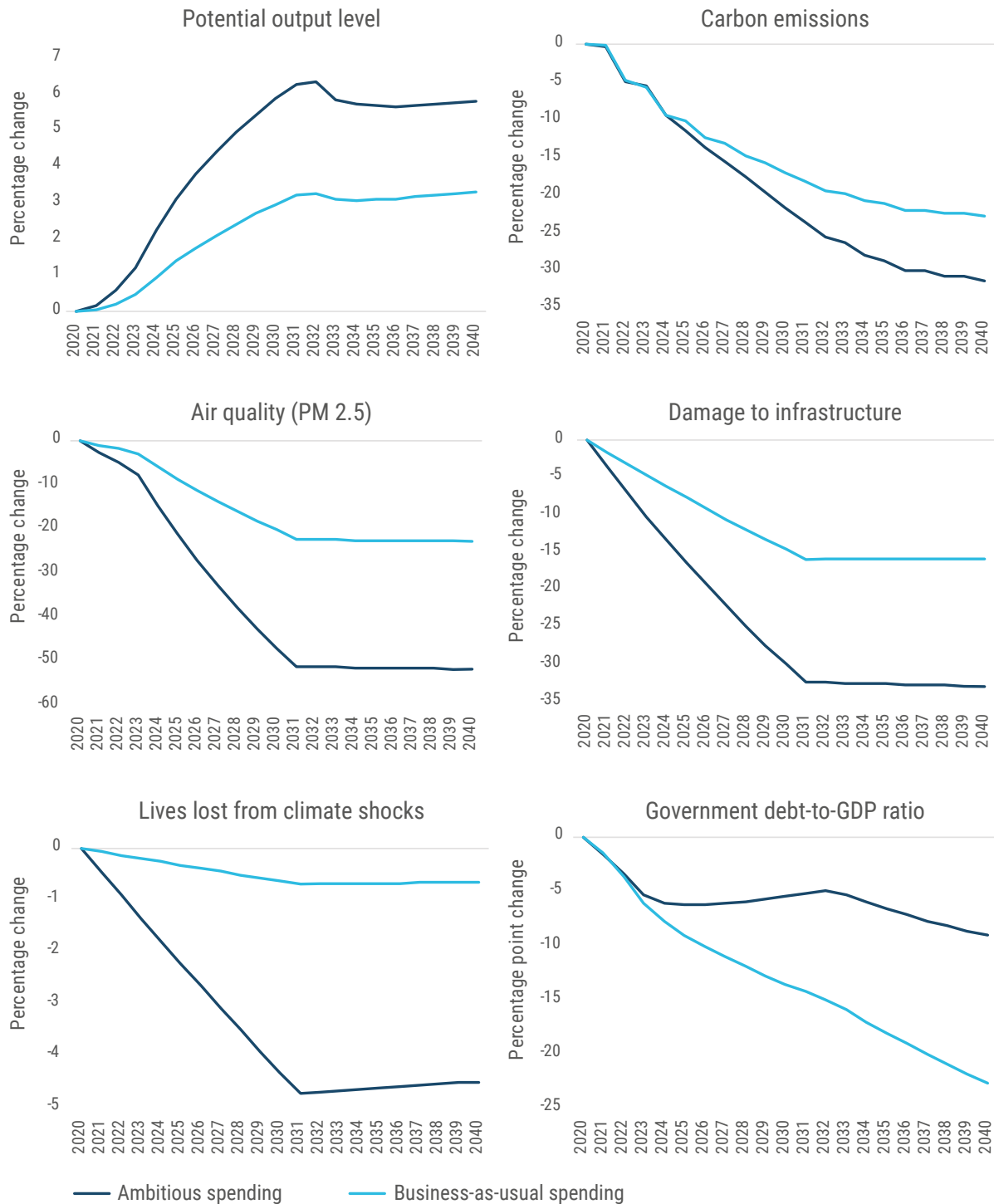
**In combining the three sub-packages, the “building forward better” package can help improve social and environmental outcomes while building resilience.** The combined package would lead to lower poverty, reduced income inequality,

lower carbon emissions and better air quality (figure 4.11). Under the *ambitious* spending level scenario, almost 180 million people in the Asia-Pacific region would escape poverty, while carbon emissions would be nearly 30 per cent below the baseline. The poverty reduction impact would be much smaller at 55 million people under the *business-as-usual* spending level scenario.

**Investing in inclusive and sustainable development would bring about significant positive economic outcomes as well.** As a result of stronger domestic demand and higher total factor productivity, the actual and potential output levels are estimated to be up to 10-12 per cent higher than the baseline while the unemployment

**Figure 4.10**

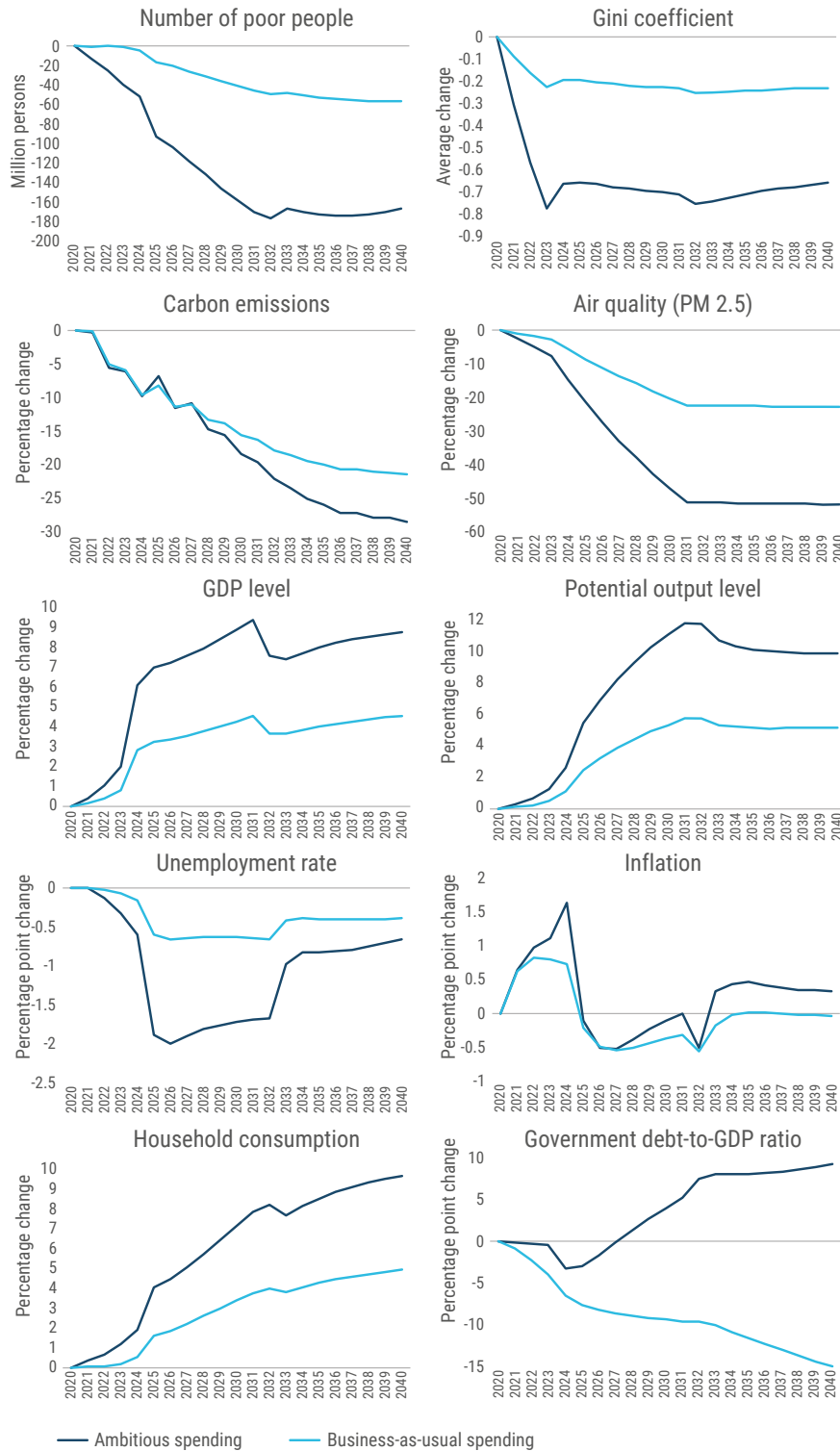
**The green development package cuts carbon emissions and improves air quality**



Source: ESCAP.

Figure 4.11

The building forward better package offers notable socioeconomic and environmental benefits



Source: ESCAP.

rate is cut by 2 percentage points. Inflation is likely to increase, but only temporarily because of the elimination of fuel subsidies and introduction of a carbon tax. On the external front, imports pick up, as part of increasing domestic demand is met through imports. Finally, the package would likely push up the public debt-to-GDP ratio by about 10 percentage points in the long run under the *ambitious* spending level scenario. While the magnitude of the public debt increase seems modest given the sizeable investment needs, it is important to note that the package also includes elimination of fuel subsidies and introduction of a carbon tax.<sup>4</sup> These are considered bold, yet attainable, policy moves in the context of Asia and the Pacific.

#### 4. Public debt sustainability analysis: looming vulnerability

It is abundantly clear that, while a policy package to build forward better can notably improve economic, social and environmental outcomes in Asia and the Pacific, the package also incurs a large fiscal cost. The public debt-to-GDP ratio is likely to increase in most countries in the long run, despite measures on environmental tax and subsidies to create fiscal space. This insight, combined with the large urgent fiscal needs to address the COVID-19 pandemic, indicates that fiscal sustainability could be at risk for many countries.

**We examine three policy scenarios to evaluate public debt sustainability.** Based on the same macroeconomic model described in section 3 above, the three scenarios assume public spending at the following levels: (a) that required to deliver the building forward better package (i.e. *ambitious* spending level); (b) that of the size of the COVID-19 fiscal stimulus; and (c) that combining the first two scenarios. Also considered are various stress tests, including the realization of selected fiscal contingent liabilities. Annex VI provides more details about these scenarios, stress tests and contingent liabilities.

**Undoubtedly, public debt ratios will jump as Governments combat the pandemic and invest in sustainable development.** For developing Asia-Pacific countries as a whole, the government debt-to-GDP ratio is projected to rise steeply from 51 per cent of GDP in 2019 to about 74 per cent of GDP by 2030 (figure 4.12). The pandemic alone would push up the debt ratio to 70 per cent in 2030, or 10 percentage points above the pre-COVID-19 baseline expectations. In Asia-Pacific least developed countries, the public debt situation fares much worse, given the much larger cost of the building forward better package. Their public debt ratio is estimated to surge from 35 per cent in 2019 to 90 per cent by 2030. The public debt hike is also likely to be significant in small Pacific island economies, reaching 62 per cent of GDP, up from 41 per cent in 2019.

**Public debt sustainability in the region is highly vulnerable to slower-than-expected economic growth.** Under the economic growth shock, which assumes that real GDP growth rates in 2021 and 2022 are one standard deviation below the baseline<sup>5</sup>, the public debt ratio in developing Asia-Pacific countries rises by another 10 percentage points, to 84 per cent in 2030 (figure 4.12). In small Pacific island economies, the sensitivity of public debt to economic growth is even more pronounced. In general, the region's public debt trajectory is also quite sensitive to the exchange rate shock, which assumes a 20 per cent nominal currency depreciation in 2021.<sup>6</sup> This is less so for the interest rate shock in which nominal interest rates are 200 basis points above the baseline in 2021.

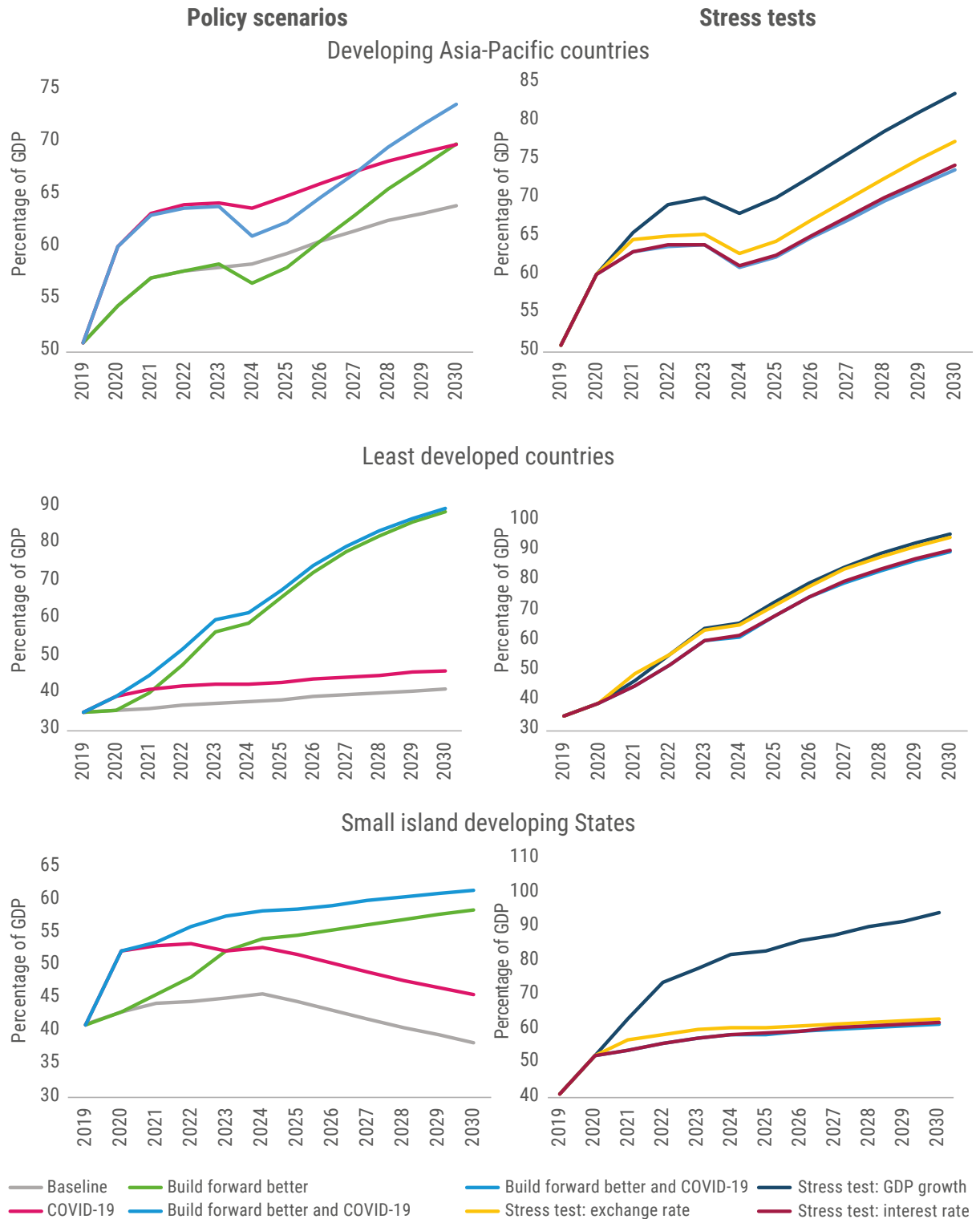
4 In countries where existing fuel subsidies are very large, implementing the building forward better package would result in a lower public debt ratio. These countries include Azerbaijan, the Islamic Republic of Iran, Kazakhstan, Mongolia, the Russian Federation, Turkmenistan and Uzbekistan.

5 Under this alternative scenario, real GDP growth rate is 4.2 and 3.1 percentage points below the baseline values in 2021 and 2022, respectively.

6 In the model, a weaker exchange rate increases the servicing cost of foreign debt, raises inflation, reduces potential output and worsens the terms of trade. The net impact on GDP and thus the government debt-to-GDP ratio varies across countries.

Figure 4.12

Public debt vulnerability is rising noticeably



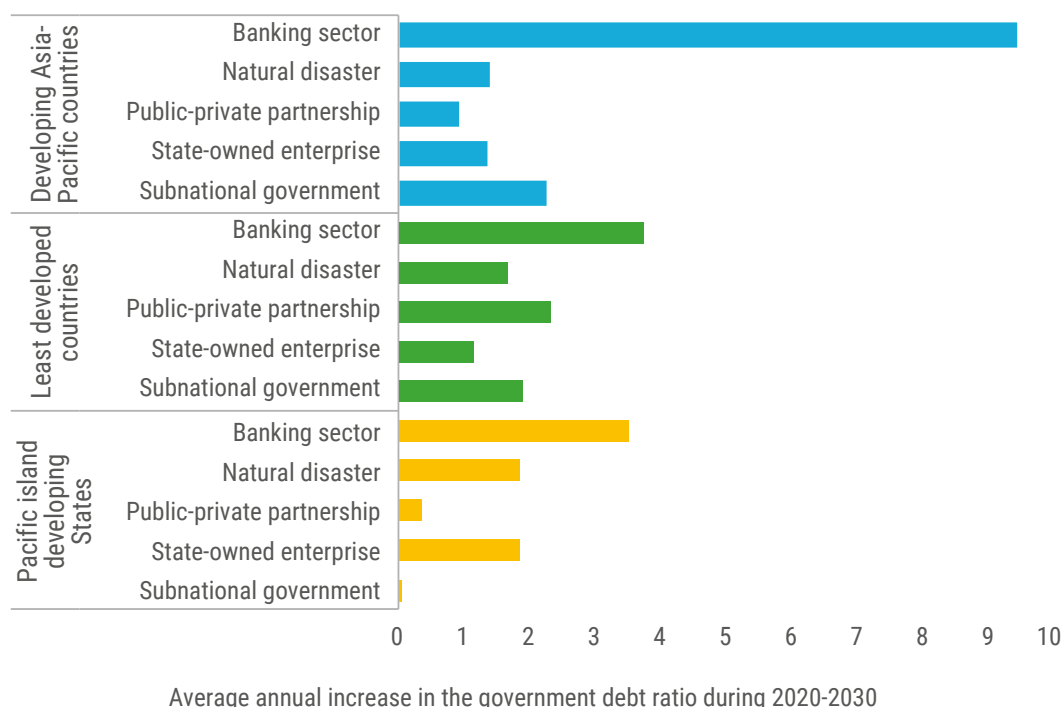
Source: ESCAP.

**Among other fiscal contingent liabilities, bank bailouts pose the greatest risk to public debt sustainability.** In developing Asia-Pacific countries, bank bailouts, where the size of fiscal support is assumed at 10 per cent of each country's bank assets, could increase the public debt ratio under the combined COVID-19 and building forward better scenario

by about 10 percentage points (figure 4.13). This is far larger than the impacts of contingent liabilities arising from natural disasters, operations of subnational governments and State-owned enterprises and State guarantees for public-private partnership projects. When considering only the least developed countries and small Pacific island economies, the public debt impact of bank bailouts becomes more comparable to other types of contingent liabilities, which is as expected given the less developed banking sectors in these countries.

**Figure 4.13**

**A banking sector crisis could put great pressure on fiscal burden**



Source: ESCAP.



## 5. Conclusions

In this chapter, we first showed that COVID-19 policy responses by Asia-Pacific economies fell short on integrating social and environmental issues. Against this background, we then proposed an illustrative policy package that would help achieve resilient, equal and green development comprising actions to ensure access to health care and social protection, close the digital divide and strengthen climate and clean energy actions. Such a package could notably reduce poverty, income inequality and carbon emissions in the long run. Yet, given the large fiscal needs to finance this policy package and combat the pandemic, the analysis shows that public debt sustainability is at risk in many Asia-Pacific economies, especially less developed ones.

This quantitative analysis involves at least two important policy implications. *First*, contrary to beliefs by some, this chapter provides concrete evidence that a move towards green development is good for economic growth and fiscal resources. For countries that are still reluctant to integrate climate and energy actions into their COVID-19 policy responses, which is currently the case for many Asia-Pacific economies, they should pursue this more actively.

*Second*, as the socioeconomic and environmental benefits under the *ambitious* level of spending are estimated to be far greater than those under the *business-as-usual* level, Asia-Pacific countries should seek to move beyond their “comfort zone”. To *build forward better*, countries cannot passively rely on the sources of financial flows that have fuelled their economies in the past. To facilitate the quest for more financial resources, the next chapter examines several fiscal and financing options that the region could explore to meet their rising financing needs.



# Chapter 5

## Building Forward Better: Fiscal and Financing Policies

### 1. Introduction

While chapter 3 demonstrated that adequate fiscal space helped increase the region's ability to withstand past adverse shocks, chapter 4 showed that building such resilience could increase the risk of public debt distress in many Asia-Pacific economies. Together, these analyses bring forward a critical policy question. How can Asia-Pacific countries mobilize additional financial resources to enhance fiscal space and maintain public debt sustainability while pursuing the 2030 Agenda for Sustainable Development? The answer to this question comprises the essence of this chapter.

**Asia-Pacific economies are facing several fiscal and financing challenges over the coming years.** In the immediate term, they are obliged to service public debts that are maturing. Over the next few years, the region will continue to face large fiscal deficits, as economic growth is projected to recover only gradually while fiscal spending may remain elevated if the pandemic is prolonged. At the same time, the amount of public debt that countries need to manage is rising. Amid tighter fiscal space, the region also needs to consider how to cope financially with the next shocks. Finally, the region will need to look beyond fiscal sources to secure adequate financial resources to meet its Sustainable Development Goals investment needs.

While available financing options are vast, **this chapter highlights six selected policy areas that would help address fiscal and financing challenges faced by the region** (figure 5.1).<sup>1</sup> To address immediate fiscal needs, *section 2* explores

<sup>1</sup> These policy options are selected because they fit certain economic conditions and opportunities in Asia-Pacific economies. These policies also expand the recent work of ESCAP on fiscal policies (ESCAP, 2018b; 2018c; 2019b; 2019c; 2019d; 2020a).

**Figure 5.1****Six fiscal and financing policy options covered in this chapter**

Source: ESCAP.

the role of debt service suspension. To cope with large fiscal shortfalls and rising debt stocks over the coming years, selected policy areas include sovereign bond financing, especially offshore public bonds and diaspora bonds (section 3), debt swaps for development (section 4) and public debt management (section 5). Finally, given shrinking fiscal resources, section 6 discusses how the region could further benefit from emergency financing mechanisms, while section 7 explores how to increase sustainable investing by public institutional investors. Section 8 provides concluding remarks and a set of specific policy recommendations.

**Based on these fiscal and financing options, this chapter contains several policy messages.** *First*, to further benefit from debt service suspension, less developed Asia-Pacific countries should participate more actively in debt negotiations with official and multilateral creditors, while emerging economies should focus their efforts on dialogues with commercial creditors. Establishing a regional debt architecture would benefit all debtors in the region.

*Second*, Governments should increasingly explore public bond financing to supplement traditional fiscal borrowings. Offshore bonds and diaspora bonds can be viewed as low-hanging fruit, as they leverage economic opportunities in many Asia-Pacific economies. Yet, the success of these bonds requires careful implementation by issuing countries.

*Third*, based on past experience, creditors and debtors should work together to enhance the effectiveness of debt swaps for development by making the financing conditions of these agreements more generous, reducing high transaction costs and ensuring that freed up funds are used as intended. These improvements would make debt swaps a more appealing policy choice.

*Fourth*, effective national public debt management features, among others, independent debt management offices, strong fiscal-monetary policy coordination and transparent and accurate debt reporting. Asia-Pacific economies have introduced various policy measures to achieve these goals, but stronger effort is clearly needed to manage a rising public debt stock in coming years.

*Fifth*, to better handle the next emergency situations, countries need to have a mix of financing modalities that match their catastrophe risks. For recurrent, low-impact disaster events, reserve funds in several Asia-Pacific countries remain inadequate. To deal with larger, rarer shocks, there remains considerable room for the region to increase the use of risk-transfer instruments, such as bonds and insurance.

*Finally*, to leverage the largely untapped potential of pension funds and sovereign wealth funds in Asia and the Pacific,

certain restrictions that govern their investment policies could be relaxed. Moreover, policymakers should strive for a long-overdue common understanding of sustainable investing, while public institutional investors themselves should aim at adopting investment strategies more oriented towards the Sustainable Development Goals.

## 2. Public debt service suspension: applying different focus for different debtors

**Creditor and debtor countries can consider various debt restructuring modalities to defer or reduce debt-service obligations.** Broadly, there are four main methods of debt restructuring (IMF, 2014). These are: (a) *debt cancellation or forgiveness*, which reduces the amount of debt; (b) *debt rescheduling or refinancing*, which amends the terms and conditions of the amount of debt owed; (c) *debt conversion and prepayment* (such as debt-for-nature swaps and debt buybacks for cash), which exchange the debt title for other things having economic value; and (d) *debt assumption*, in which a new debtor assumes the former debtor's outstanding liability. This section is focused on debt rescheduling, particularly debt service suspension, to relieve immediate financing needs.

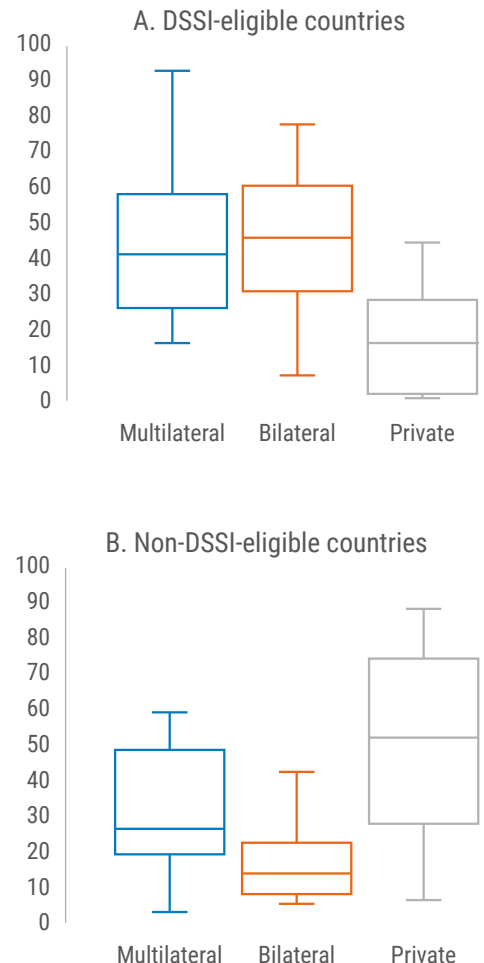
**A large part of public debt in less developed Asia-Pacific economies is owed to official bilateral and multilateral creditors.** In 2019, official bilateral creditors and official multilateral creditors each accounted for about 45 per cent of public external debt stocks in 20 low-income Asia-Pacific countries. Such a ratio can exceed 90 per cent in the case of multilateral creditors (Solomon Islands) and almost 80 per cent for bilateral creditors (Myanmar) (figure 5.2A). Hence, the success of debt relief efforts for less developed countries in the region depends notably on actions by official creditors. In contrast, **private creditors have played an active role in financing fiscal shortfalls in emerging Asia-Pacific economies** (figure 5.2B), accounting for slightly more than half of their public external debt stocks in 2019. The greater role of private creditors is mainly due to these countries' ineligibility for concessional financing and lower sovereign credit risks.

**Among official bilateral creditors, much of the maturing debt is owed to China.** For less developed Asia-Pacific economies, China accounts for a large share of their debt servicing obligations that are due in 2021 (figure 5.3). In terms of value, debt repayments to China stand at about \$4.1 billion. In some

**Figure 5.2**

**Much of public debt in less developed Asia-Pacific economies is owed to official lenders**

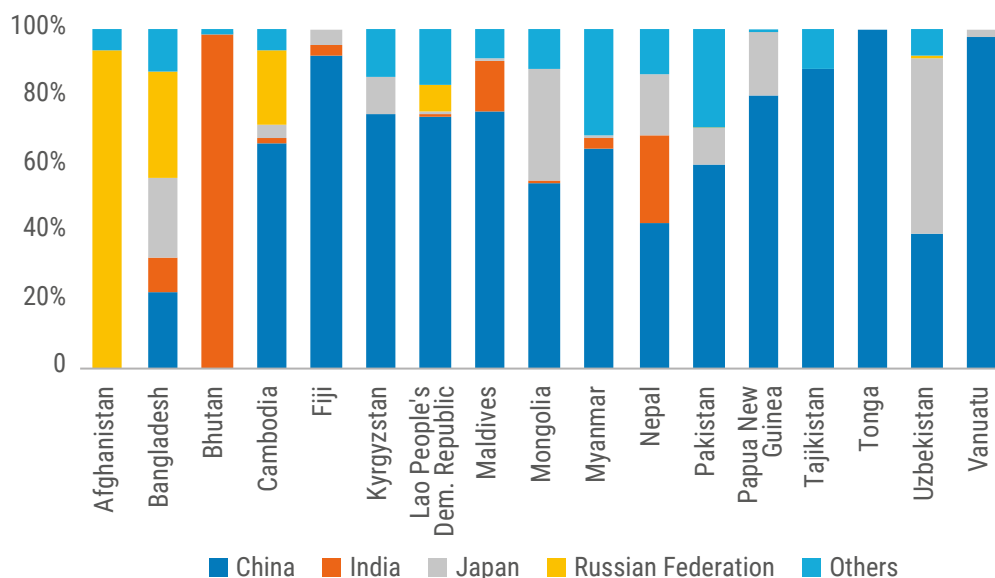
Composition of external public and publicly guaranteed debt, by creditor type, 2019



Source: ESCAP, based on World Bank 2021 International Debt Statistics.

Note: DSSI = Debt Service Suspension Initiative. The upper and lower limits of the enclosed box correspond to the 75th and 25th percentiles, respectively. The horizontal line within the box depicts the median. The vertical line shows the range with the uppermost (lowermost) point reflecting the maximum (minimum) values.



**Figure 5.3****China accounts for a large share of official bilateral debt services due in 2021**

Source: ESCAP, based on World Bank 2021 International Debt Statistics.

small Pacific island economies, such as Fiji, Tonga and Vanuatu, China accounts for more than 90 per cent of their maturing official bilateral debts. Similarly, virtually all bilateral debts maturing in 2021 in Afghanistan and Bhutan are owed to the Russian Federation and India, respectively. Finally, as a creditor country, Japan plays a key role in such countries as Mongolia and Uzbekistan.

#### **Debt relief remains untapped, despite several Asia-Pacific countries benefiting from some initiatives.**

The Debt Service Suspension Initiative (DSSI) was agreed in April 2020 and is aimed at temporarily halting the servicing of official bilateral debts owed to G20 countries by 73 low-income countries around the world. The initial suspension period was set to December 2020 but later postponed to June 2021. For the Asia-Pacific region, of 24 eligible economies, 10 have participated as of February

2021 (figure 5.4). The combined debt service savings in these participating countries are estimated at more than \$4.6 billion. Yet, the region can further benefit from DSSI. The estimated potential savings among 13 non-participating countries are almost \$1.4 billion. Moreover, among 11 Asia-Pacific countries with high risk of overall or external debt distress, only 6 of them have participated.

#### **There is room for relevant creditors to step up their debt relief effort.**

Among others, DSSI should extend beyond low-income countries and official bilateral debts, as well as consider options to reduce the amount of debt stocks (Ellmers, 2020). Additionally, DSSI implementation should include transparent operations by all official creditors, including national policy banks, and a common agreement that provides clear debt transparency (IMF and World Bank, 2020). More broadly, in the absence of global or regional debt architecture, debtor countries have to proceed with separate, time-consuming negotiations with different creditors. This could also result in an unfair situation when creditors that do not participate in the negotiation, such as commercial creditors, benefit from debt relief granted by other creditors. For instance, between May and December 2020, debt services to private creditors by 46 DSSI-participating countries amounted to \$6.9 billion, while their DSSI savings were smaller, at \$5.3 billion (Fresnillo, 2020).



**Figure 5.4**

**More Asia-Pacific countries could participate in the Debt Service Suspension Initiative**

		Risk of overall debt distress			
		Not available <sup>a</sup>	Low	Moderate	High
Participation in DSSI	<b>Yes</b>	Fiji (13.4) Pakistan (3,645.4)	Myanmar (379.9) Nepal (24.8)		Afghanistan (39.3) Maldives (50.7) Papua New Guinea (326.9) Samoa (9.5) Tajikistan (63.8) Tonga <sup>b</sup> (6.3)
	<b>No</b>	Mongolia (69.9)	Bangladesh (331.9) Cambodia (219.2) Timor-Leste (0.0) Uzbekistan (257.3)	Bhutan <sup>b</sup> (145.4) Kyrgyzstan (52.1) Solomon Islands (1.5) Vanuatu (6.2)	Kiribati Lao People's Democratic Republic (315.0) Marshall Islands <sup>b</sup> Micronesia (Federated States of) Tuvalu <sup>b</sup>

Source: Debt Service Suspension Initiative, as of 11 February 2021.

Note: DSSI = Debt Service Suspension Initiative. Numbers in parentheses are potential DSSI savings, where available, in millions of United States dollars.

<sup>a</sup> Countries not covered in debt sustainability analysis for low-income countries.

<sup>b</sup> Countries the debt distress risk of which is based on external debt only.

**As a large creditor, China has engaged in debt relief efforts for developing countries.** With about 20 per cent of external debt in all DSSI-eligible countries owed to China (Huang and Brautigam, 2020), China has so far extended debt relief worth \$2.1 billion (China, 2020). Over a longer period, China has cancelled about \$3.4 billion of its official zero-interest loans to African countries, while restructuring an additional \$7.5 billion in debt, primarily through maturity extensions, during the period 2000-2019 (Acker, Huang and Brautigam, 2020). Despite these notable efforts by China, challenges remain due to, say, the presence of numerous Chinese public and private lenders in each debtor country and a complicated, loan-by-loan negotiations approach (Brautigam, 2020).

### 3. Sovereign bond financing: going beyond traditional fiscal borrowing

**Governments can finance their fiscal deficits through various channels.** These include, among others: (a) *raising taxes*; (b) *increasing debt*, e.g. government borrowing and bond issuance; (c) *printing money*, in which the central bank

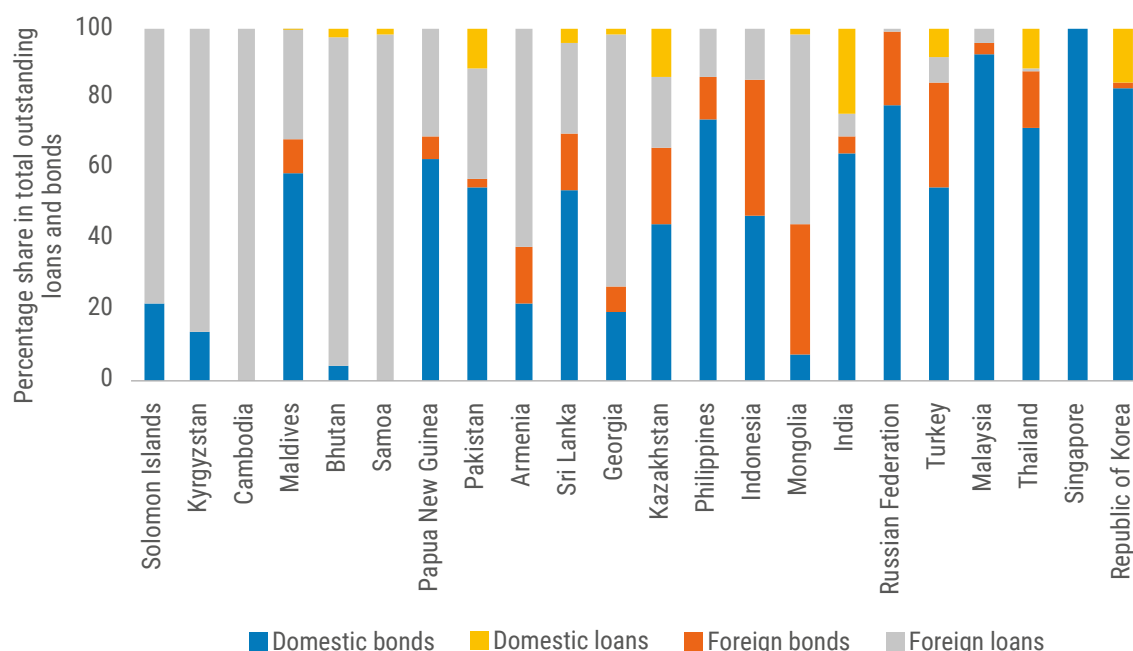
would hold part of newly issued government debt instruments through creation of additional currency; and (d) *emergency financial assistance from multilateral development banks*. During such emergencies as the COVID-19 pandemic, Asia-Pacific economies also explored less traditional approaches. Examples include a land monetization plan for some public entities in India, and central bank asset purchases in several emerging economies (box 5.1).

**Asia-Pacific countries with underdeveloped financial markets have relied on external loans, while those with advanced financial markets rely more on bond financing** (figure 5.5). Even as concessional

**Box 5.1****Asset purchases by central banks in Asia and the Pacific – proceed with caution**

To cope with the economic slump and pressing fiscal needs, central banks in several emerging Asia-Pacific economies engaged in asset purchase programmes for the first time in 2020. In March, the central banks of India and Thailand purchased government bonds in the secondary market worth about \$5.5 billion and \$3.1 billion, respectively. In Indonesia and the Philippines, the central banks purchased government bonds in both primary and secondary markets. Finally, Turkey's central bank introduced a programme for outright sovereign bond purchase and increased the maximum value of purchases under open market operations.

While these asset purchases help to preserve government bond yields and revive much-needed market sentiment during this unusual time, developing Asia-Pacific countries should proceed with caution. In developed countries, asset purchases by central banks are adopted partly because the policy rates are already close to zero per cent so the room for further monetary easing is limited. However, this is currently not the case in most Asia-Pacific economies. More broadly, given that institutional quality in developing countries tends to be weaker than that in developed countries, large-scale asset purchases by central banks could jeopardize fiscal discipline, erode central banks' independence and credibility, and lead to inflation overshooting. As such, from the long-term perspective, this may be deemed as a less viable policy option, especially at the scale being implemented in developed countries.

**Figure 5.5****Governments in less developed Asia-Pacific economies rely heavily on external borrowing**

Source: ESCAP, based on IMF Government Finance Statistics, BIS Debt Securities Statistics, World Bank International Debt Statistics and national sources.

Note: The order of countries is sorted according to the IMF Financial Development Index in 2018, from the least to most developed countries.

financing makes external borrowing the only available or the cheapest source of finance, it is not the most conducive for long-term development. In contrast, a sovereign bond market can help not only to diversify investors' portfolios but also establish a benchmark yield curve for corporate bonds, which fosters the use of corporate bonds to fund business development. Thus, developing capital markets is one of the main pre-requisites to take advantage of additional financing options.

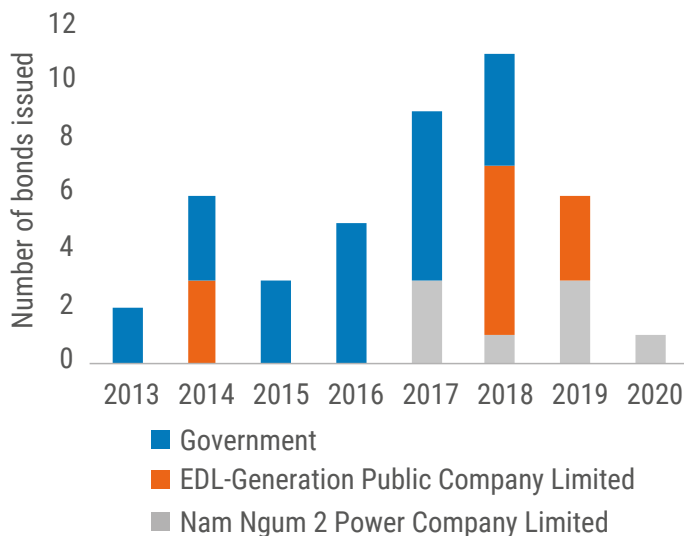
Against this background, we examine sovereign bond financing, especially offshore sovereign bonds and diaspora bonds, as possible financing options. These bonds are considered suitable for countries with certain development opportunities and impediments.

### 3.1. Offshore public bonds: leveraging neighbours' savings

**For countries with smaller market size, less developed capital markets or weaker credit ratings, public bonds could be issued in the economy of a more developed neighbour.** Such issuance offers certain benefits. *First*, given small domestic savings, funds mobilized from the sale of bonds in the domestic market may be inadequate for fiscal needs.

**Figure 5.6**

**Lao entities have issued many baht-denominated bonds in Thailand**



Source: ESCAP, based on data from Cbonds.

*Second*, developing domestic bond markets is a lengthy process so it cannot support urgent fiscal needs. *Third*, a poor sovereign credit rating means that issuing government bonds in hard currencies in major international markets is either impossible or possible only with high interest rates.

**The issuance of bonds by the Lao People's Democratic Republic in Thailand is noteworthy.** During the period 2013-2020, the Lao Government and other entities issued a total of 43 Thai baht-denominated bonds in Thailand (figure 5.6). As of end-2020, the total value of outstanding bonds, with the longest maturity date of 2033, is about \$2.1 billion. The first issuance in 2013 raised 1.5 billion baht, or about \$49 million, from an unrated three-year bond. Arranged by a Thai bank, the proceeds were used to fund hydropower projects (Polkuamdee, 2013). Over time, the size and maturity increased. Sales in 2017, with a 15-year maturity and BBB+ rating, generated 14 billion baht (approximately \$431 million) (Srimalee, 2017). Financial institutions accounted for almost 60 per cent of the buyers, followed by large investors and asset managers. In addition to baht bonds, the Lao People's Democratic Republic also issued United States dollar-denominated public bonds in Thailand in 2015, which raised \$182 million (Laos, 2015).

**Successful issuance of offshore sovereign bonds depends on features of the host countries.** *First*, host countries need to have rather effective capital markets and sizeable domestic savings. *Second*, investment rules in host countries should permit

the issuance of non-investment grade bonds. For example, Thailand eased restrictions on the sale of unrated bonds and cancelled the requirement that all foreign issuers of baht-denominated bonds have investment grade ratings (Boey, 2013). *Finally*, if institutional investors in these economies are allowed to invest in non-investment grade bonds and/or there is an appetite for higher-yield sovereign debt among other types of investors, then this is considered as a plus.

**Strong prior economic ties between host and issuing countries are also critical.** Such ties help increase understanding of economic developments and gauge creditworthiness of unrated markets. In the case of the Lao People's Democratic Republic, exports of hydroelectricity to Thailand, which were partly denominated in baht, accounted for a large part of the country's export revenues. Moreover, Thai banks had lending experience with earlier hydroelectric projects, while many projects financed by the baht-denominated bonds were carried out by Thai construction companies. Also, certain bond repayments were secured by a long-term agreement to purchase electricity by a Thai State-owned entity (Boey, 2017).

**Regional financial cooperation initiatives also play an important role.** For instance, the ASEAN+3 Multi-Currency Bond Issuance Framework was launched to facilitate intraregional fixed income transactions by promoting common market practices for bond issuance, such as disclosure standards and common documents. Similarly, the

Asian Bond Market Forum tries to foster the standardization of market practices and harmonization of regulations relating to cross-border bond transactions.

**Despite its benefits, offshore public bond issuance should be pursued cautiously.** After all, issuing bonds offshore in a foreign currency raises a Government's vulnerability to exchange rate risks. More broadly, policymakers in the issuing countries should view offshore bonds as a supplement to, rather than a substitute for, well-developed capital markets at home. For the host countries, investing in unrated and non-investment grade bonds offers potentially higher yields but also carries higher risks of default.

### ***3.2. Diaspora bonds: mobilizing savings of countries' own emigrants***

**Diaspora bonds tap savings held by emigrants and could offer several benefits.** For countries with limited access to foreign capital, these bonds offer a fixed-rate source of income, while enabling citizens to contribute to the development of their origin economies. In general, diaspora bonds' interest rates can be lower than those of sovereign bonds because diasporas often have a lower country risk perception than other international investors. Diasporas are also less likely to cease bond holding during financial panics. In some cases, diasporas may also be willing to accept lower interest rates than the market interest rate for government debt because of their desire to support their home countries, although the evidence on such a discount is inconclusive (Akkoyunlu and Stern, 2018). For emigrants, diaspora bonds offer better investment opportunities, as much of their savings are held in bank deposits in destination countries with low interest rates.

**Large remittances received by several Asia-Pacific countries present an opportunity for diaspora bonds.** In 2019, Bangladesh, China, India, Pakistan, the Philippines and Viet Nam were among the world's top 10 remittance recipients in terms of value (ranging between \$17 billion and \$83 billion). As a share of GDP, Kyrgyzstan, Nepal, Tajikistan and Tonga are high in the global ranking, with average remittances of more than 25 per cent of GDP during the period 2017-2019. More broadly, estimates suggest that annual diaspora savings amount to at least \$1 billion in 17 Asia-Pacific countries, including in least developed countries, such as Afghanistan, Cambodia, the Lao People's Democratic Republic and Myanmar (World Bank, 2020c).

**Several Asia-Pacific countries have issued or are considering the issuance of diaspora bonds.** The most predominant example is India, which issued five-year diaspora bonds in 1991, 1998 and 2000, generating \$32 billion in total. Such countries as Bangladesh, Nepal, Pakistan, the Philippines and Sri Lanka also have had experience with diaspora bonds, with varying degrees of success. Meanwhile, Armenia has recently considered the use of diaspora bonds for Sustainable Development Goal investments (Lieberman, 2018), while Georgia also expressed some interest. Finally, amid the COVID-19 pandemic, Indonesia is considering the issuance of its first-ever diaspora bonds (Akhlas, 2020).

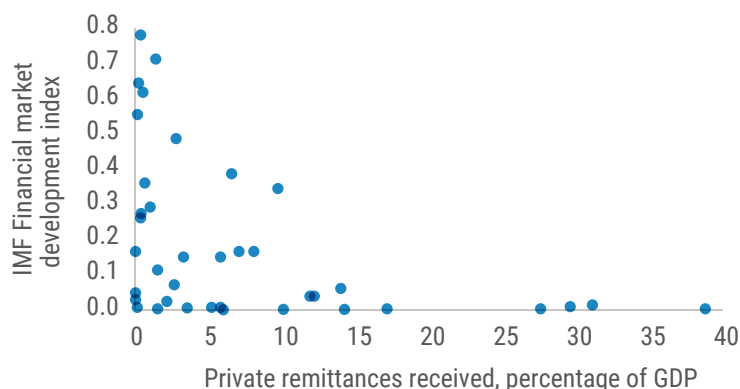
**To fully leverage diaspora bonds, several enabling conditions and policy actions need to be in place. First, at a broad level, domestic capital markets need to be sufficiently developed.** However, capital markets remain underdeveloped in most Asia-Pacific countries with large remittances (figure 5.7). Past experience shows that countries that have previously issued diaspora bonds, such as Bangladesh, Pakistan, the Philippines and Sri Lanka, are those that receive sizeable remittances and have reasonably developed capital markets.

**Second, prior to the sales, understanding of the willingness and ability of diasporas in bond investments helps determine the amount of funds that diaspora bonds could mobilize.** Apart from having a large pool of emigrants, their income

level and financial literacy also matter. When Nepal first issued diaspora bonds in 2010 and 2011, the sales targeted emigrants in Arab States of the Persian Gulf and Malaysia who were mostly low-skilled with limited savings. This aspect, along with low interest rates and inadequate marketing campaigns, explains the limited success of that scheme (Okonjo-Iweala and Ratha, 2011; Ratha and Silwal, 2011). Meanwhile, experiences from India suggest that patriotic discounts are generally larger among first-generation diasporas because they have stronger ties with their ancestral countries (Ketkar and Ratha, 2009). Relatedly, diaspora communities that have strong trust in Governments are more likely to invest in diaspora bonds. In this context, Georgia has established a ministry on diaspora affairs, which organizes regular gatherings among the country's emigrants (Strokhecker, 2016). Finally, Akkoyunlu and Stern (2018) showed that diaspora bonds are more likely to succeed when diaspora communities are closer to their countries of origin and their Governments possess better sovereign credit ratings.

**Figure 5.7**

**Underdeveloped capital markets are limiting the potential of diaspora bonds**



Source: ESCAP, based on World Bank's World Development Indicators and IMF's Financial Development Index Database.

**Third, the structure of diaspora bonds is important.** Diversity in bond structure, such as maturity, currency denomination, fixed versus floating rates, frequency of interest payments, minimum purchase amounts, conditions on early redemption and payment arrangements, is key (Benson and Owuor, 2019). For example, low minimum purchase requirements would enable greater participation by emigrants with small savings. In Bangladesh, a taka-denominated diaspora bond not only

carried higher interest rates than other government bonds but was also tax-exempt (Maimbo and Ratha, 2005).

**Finally, less developed countries may need technical support from international development partners.**

For example, to understand and comply with regulatory requirements on investment regimes in destination countries, bond issuers normally have to pay high transaction costs. Development partners can help absorb such costs by providing relevant information and initial assessments (Rustomjee, 2018). Technical studies to assess financial risks associated with diaspora bonds, such as exchange rate volatility, are also useful.

#### 4. Debt swaps for development: learning lessons from the past

As highlighted in section 2, countries can explore various public debt restructuring modalities. Here, we focus on debt conversion, especially debt swaps for development, to reduce debt obligations while promoting sustainable development.

**Rising public debt levels in developing countries have kindled interest in debt swaps for development.<sup>2</sup>**

The swap agreements have been used to support development areas,

such as health care, education and environmental protection, especially during the 1980s and 1990s. Even prior to the COVID-19 pandemic, the United Nations encouraged the use of debt swaps, especially for climate actions, amid rising public debt in developing countries (ECLAC, 2017; United Nations, 2019). After the outbreak of the current pandemic, interest in debt swaps has increased, both from debtor countries, such as Pakistan (Shehzad, 2020), and creditor countries in Europe (Pleeck and Gavas, 2020; Widge, 2021).

**Debt swaps for development offer benefits beyond reducing debt obligations and improving debt sustainability.**

Compared with other debt reduction modalities, swaps tend to have more direct benefits for sustainable development. For example, during the period 1985-2015, debt-for-nature swaps worldwide involved debt amounting to more than \$2.6 billion and resulted in transfers of about \$1.2 billion to conservation projects (UNDP, 2017). Other benefits of debt swaps include reduced exposure to exchange rate risks by debtor countries, potential to attract co-financing by other development partners and increased capacity of local organizations that implement the projects (Berensmann, 2007).

**Several Asia-Pacific economies have engaged in debt swaps for development, both as creditors and debtors.**

Among others, the debtor countries were Bangladesh, Indonesia, Pakistan and the Philippines. For these transactions, which took place mostly between the 1980s and early 2000s, the creditors or donors included Australia, Germany, Italy, the Netherlands, Norway, the United States, as well as such organizations as the World Wildlife Fund. Meanwhile, as a creditor country, the Russian Federation agreed in 2017 to cancel Mozambique's public debt of \$40 million (Jerving, 2017), in which the freed up fund was used to implement a school feeding programme.

**The effectiveness of debt swaps for development has been rather mixed.**

Typically, debt swaps are considered effective if they: (a) provide the debtor Government's budget with additional resources; (b) result in additional resources for the target development areas; (c) have a notable effect on debt reduction in a debtor country; and (d) are consistent with the debtor country's policy priorities (Cassimon, Essers and Renard, 2009). In this regard, the first wave of debt swaps was often too small to significantly reduce the debtor countries' debt burden (Cassimon and Vaessen, 2007). In many cases, the size of the counterpart fund set up by debtor countries incurred large fiscal costs when compared with the

<sup>2</sup> There are two broad categories of swap agreements. The first is bilateral swaps between two Governments, in which a creditor country agrees to cancel the debt of a debtor country in exchange for the debtor's commitment to spend part of the freed up fund for agreed development purposes. The second type is trilateral swaps, in which a third party (typically a non-governmental organization) purchases the debt title of a developing country in the secondary market at a discounted value and then transfers it back to the debtor in exchange for the Government's commitment to mobilize local currency funds for specific development projects.



amount of debt relief they received. In the case of Indonesia, studies also suggest mixed outcomes (Cassimon, Prowse and Essers, 2011; Essers, Cassimon, and Fauzi, 2013). On a positive note, the debt swaps helped raise about \$385 million over a 20-year period, while these agreements were broadly consistent with national development policies. Yet, due to strong frontloading of counterpart payments, these swaps reduced Indonesia's fiscal space in the first few years of operation. Government's ownership of projects also appeared limited because separate trust funds were established and operated with their own procedures.

**Several aspects of debt swaps for development can be improved. First,** after determining the level of political interest, **an independent feasibility study should be carried out.** Among others, such a study should identify the amount and profile of public debt that can be swapped, the beneficiary projects, co-financing sources, the debt discount or conversion rate and, if any, the payment schedule for organizations that are responsible for project implementation (UNDP, 2017).

**Second, relevant stakeholders should try to reduce the high transaction costs of debt swaps.** Examples of these costs include a time-consuming negotiation process, conducting feasibility studies, hiring environmental experts to structure the debt deal and paying for financial and legal fees. For public or bilateral agreements, one policy option is the preparation of guidelines on general terms and conditions of debt swaps by international development organizations, which would help reduce the time cost in finding general information by less experienced creditor and debtor countries (Steele and Patel, 2020).

**Third, the scale of debt swaps for development should be increased.** For instance, the arrangements could shift from a project- to a programme-based approach, whereby proceeds may be used for direct budget support (Ainio, 2020). Debt swaps can also be collectively carried out by multiple creditors or combined with other debt reduction modalities, such as debt forgiveness (Caliari, 2020). Relatedly, other donors beyond creditor countries could seek to augment the size of counterpart funds, or financially support debtor countries that are unable to meet the required size of counterpart funds (World Bank, 2019a).

**Fourth, to ensure that additional financial resources are made available, minimize the fund fungibility issue.** As debt

swaps are typically considered as part of their ODA commitments, *creditor countries* are tempted to cut the amount of ODA that may have been planned elsewhere (Ito, Sekiguchi and Yamawake, 2018). Governments of *debtor countries*, on the other hand, tend to cut spending on development areas that have received debt swap proceeds or use the proceeds for other purposes. Such behaviours should be discouraged by using historical data on public spending in different development areas as a benchmark to gauge the extent of fungibility.

**Finally, practices should be adopted to ensure prudent operation of the arrangements.** To reduce fiduciary risks, a strong monitoring mechanism should be in place, such as documentation produced by independent auditors (Kamel and Tooma, 2005). To increase country ownership, requirements on the use of swap proceeds should be based on spending principles (e.g. climate resilience) rather than a specific list of project targets (Steele and Patel, 2020). Finally, where possible, effort should be made to generate revenues from beneficiary projects, such as biodiversity protection projects that promote ecotourism (UNDP, 2017).

**Recent shifts in the financial landscape could foster the use of these swaps.** Unlike the first wave of debt swaps when developed economies played a leading role, some *Asia-Pacific economies have emerged as key bilateral creditors*. For example, public debt owed to China by 73 low-income countries worldwide was estimated at \$102 billion in 2018 (Westphal and Liu, 2020). Another important shift in the financial landscape is the

*emergence of sustainability-oriented financial institutions and investors.* For emerging Asia-Pacific economies where much of their external public debt is owed to commercial creditors, these financial institutions and investors can help promote the use of swap agreements, both as creditors and donors/third parties.

## 5. Public debt management strategy: adopting good practices

As debt vulnerabilities are likely to increase over the coming years (chapter 4), the region needs more effective public debt management in order to benefit from lower financing costs and better risk management. This section highlights selected debt management practices that Asia-Pacific economies should consider.

**At a broad level, having clear debt management objectives and strong fiscal-monetary coordination helps improve decision-making.** Unclear objectives can lead to poor decisions on how to manage the existing debt stock and what types of debt instruments to issue, which results in high debt servicing costs, as investors must factor in higher risk premiums due to uncertainty. Moreover, beyond coordination among public agencies that work on public debt management, coordination between fiscal and monetary policies is also necessary because they are interdependent. For example, excessive fiscal shortfalls that are financed by “printing money” could lead to hyperinflation and a balance of payments crisis.

**Public debt management offices should be separate and accountable.** In most Asia-Pacific countries, debt

management agencies operate under ministries of finance, while the remainder are either under central banks or jointly managed by ministries of finance and central banks. When a central bank conducts debt management policy, conflicting policy objectives may arise. For instance, abundant market liquidity may suggest that monetary tightening is needed but this could undermine government borrowing from the financial markets. Having independent debt management units not only helps avoid such policy conflict, but also strengthens policy credibility, as they signal the Government’s commitment to meeting debt obligations (El-Erian, 2013).

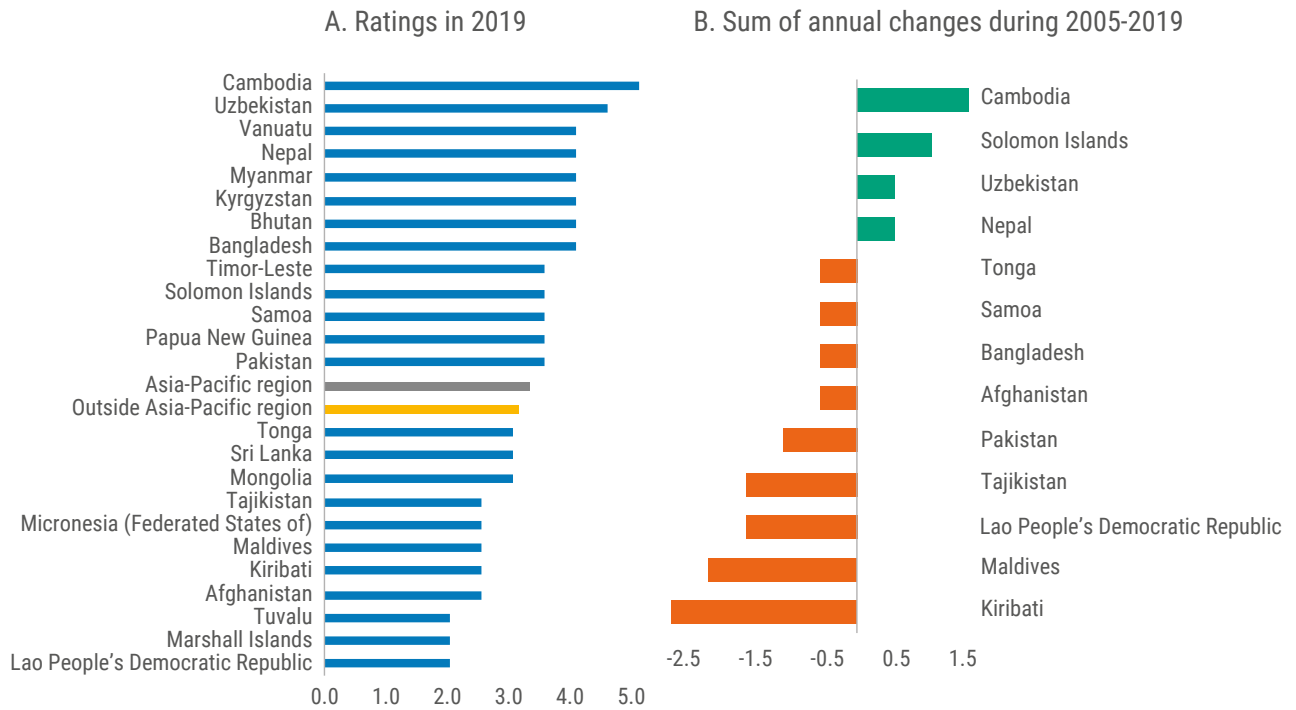
**Collection, monitoring and reporting of public debt data are fundamental to good debt management practices.** Having timely, accurate and comprehensive public debt data helps countries to better manage public liabilities and identify a potential debt crisis. Typically, the quality of debt reporting is constrained by insufficient incentives to produce reliable data, limited staff capacity, poor information technology infrastructure and absence of coordination between different institutions that handle data dissemination. Poor procedural systems have also led to erroneous debt service payments.

**The quality of public debt management in several Asia-Pacific countries appears to have deteriorated.** Within the region, the quality of public debt management varies rather notably (figure 5.8A). In strongly performing countries, such as Cambodia and Uzbekistan, there is generally a clearly defined legal framework for public borrowing, strong coordination between debt management and macroeconomic policies and effective debt management units (World Bank, 2018). These countries also typically issue an annual debt management strategy and regularly produce comprehensive, accurate statistics on public debt. Over time, public debt management has become less effective in several Asia-Pacific countries during the period 2005-2019 (figure 5.8B). Unsurprisingly, countries that are currently top performers have witnessed improvements in their ratings in the several past years.

**As they stand, public debt dissemination practices need improvement.** Asia-Pacific countries generally perform better on the accessibility, timeliness and completeness of debt reporting (figure 5.9). In contrast, much less is publicly reported on terms of recent external loan contracts and assessments of contingent liabilities. Publications that enhance the transparency of future debt operations, such as an annual borrowing plan and medium-term debt strategy, in most countries are also either publicly unavailable or

**Figure 5.8**

**Public debt management has become weaker in several Asia-Pacific countries**



Source: ESCAP, based on World Bank's Country Policy and Institutional Assessments (CPIA) rating on Debt Policy and Management.  
Note: On a 1-6 scale, higher scores denote lower risk of debt distress and more effective public debt management.

available but without specific targets on sources of financing. Similarly, medium-term debt strategies are often available for less than three years, even in such emerging economies as Indonesia, Kazakhstan and the Philippines (PEFA, 2020). There may also be inconsistencies between annual borrowing plans and the approved debt strategy. At the country level, examples of challenges include discrepancies over fiscal and financial information in the Philippines (IMF, 2015), limited harmonization across agencies on statistical concepts and collections in Cambodia (IMF, 2019) and inconsistencies on bank financing data between fiscal and monetary authorities in Bhutan (IMF, 2018).

**Several mechanisms have been adopted to ensure fiscal-monetary policy coordination in Asia and the Pacific.** For example, Indonesia established the Financial System Stability Forum, which comprises the Ministry of Finance, the Bank of Indonesia, the Financial Services Authority and the Deposit Insurance Institution (Jayaraman, Boodhoo, and Tari, 2015). The four institutions convene regular meetings and share their assessments on macroeconomic policy.

In the Philippines, all government borrowings need to be approved by the Monetary Board, which includes representatives from the Ministry of Finance. In Vanuatu, the central bank provides the Ministerial Budget Committee with views and advice.

**Several countries are moving towards separate and accountable debt management offices.** In New Zealand and Thailand, separate debt management offices were introduced in 1988 and 1999, respectively. More recently, the Islamic Republic of Iran, Nepal and Malaysia established debt management offices in 2015, 2018 and 2020, respectively. Meanwhile, India set up a unit that serves as an interim arrangement before launching an independent debt management agency.

**Figure 5.9****Information on fiscal borrowing plans and contingent liabilities is mostly absent**

	Public debt reporting						Debt management		Contingent liabilities
	Debt accessibility	Completeness			Timeliness		Annual borrowing plan	Debt management strategy	
		Information on last loans	Instrument coverage	Sectorial coverage	Periodicity	Time lag			
Afghanistan									
Bangladesh									
Bhutan									
Cambodia									
Fiji									
Kiribati									
Kyrgyzstan									
Lao People's Democratic									
Maldives									
Marshall Islands									
Micronesia (Federated States of)									
Mongolia									
Myanmar									
Nepal									
Pakistan									
Papua New Guinea									
Samoa									
Solomon Islands									
Tajikistan									
Timor-Leste									
Tonga									
Tuvalu									
Uzbekistan									
Vanuatu									

Source: World Bank Debt Reporting Heat Map.

Note: Cells highlighted in red indicate that debt reporting is not publicly available; those in orange mean limited availability; yellow means partial availability; and green means full availability.

**Efforts are being made in strengthening the accountability of debt management agencies.** In New Zealand, the debt management office's advisory board comprises private sector representatives in order to increase the oversight. Thailand's debt management office releases an overview of its annual implementation plan and how that plan has resulted in new debt management directions. Finally, in Viet Nam, the State Audit Office has carried out annual auditing of public debt management since 2011. Such auditing verifies public debt reports and evaluates the effectiveness of debt management activities (Viet Nam, State Audit Office, 2020).

**Various countries introduced measures to enhance public debt reporting.** Since 2017, Sri Lanka started publishing a quarterly calendar for treasury bond issuances, which has helped enhance the predictability of the primary auction process. In Malaysia, recent budget documents contain reporting of debt sustainability analysis, State guarantees and possible future payments relating to public-private partnership projects (IMF, 2020d). In Nepal, the managerial structure is being redesigned to consolidate data on domestic and external government debts, guarantees and on-lending activities (World Bank, 2019b).

## 6. Emergency financing mechanisms: getting ready for future shocks

**Effective emergency financing mechanisms help enhance preparedness for future shocks.** Only about one third of countries worldwide can sufficiently respond to public health emergencies, partly due to inadequate financial resources

and rigid emergency responses (Osewe, 2017). In the short run, an effective financing mechanism can provide quicker, larger financial assistance during emergency situations, when speed and scale of spending are critical to limiting the devastating impacts of shocks. In the longer term, an effective financing mechanism can also help countries to reduce fiscal contingent liabilities and face smaller post-event budgetary disruptions. Given these benefits, Governments in Asia and the Pacific need to consider various financing modalities and instruments to cope with emergency situations. Here, we mainly touch upon shocks stemming from natural disasters and disease outbreaks, although immediate financing is also needed for events that affect famine and displaced populations.

**There are several gaps in disaster risk financing strategies in Asia-Pacific economies.** Such countries as Armenia, Cambodia, Georgia, the Lao People's Democratic Republic, Myanmar and Papua New Guinea face a large funding gap when dealing with recurrent or major disaster events. Yet, for others, such as Uzbekistan, it is unclear how the information collected on disaster impacts is used for fiscal planning. Similarly, there is limited information on contingent liabilities due to disaster risks in Pakistan (World Bank, 2020a), while Nepal's macroeconomic assessment of disaster risk covers only hazard risks (ADB, 2019). Finally, operational issues,

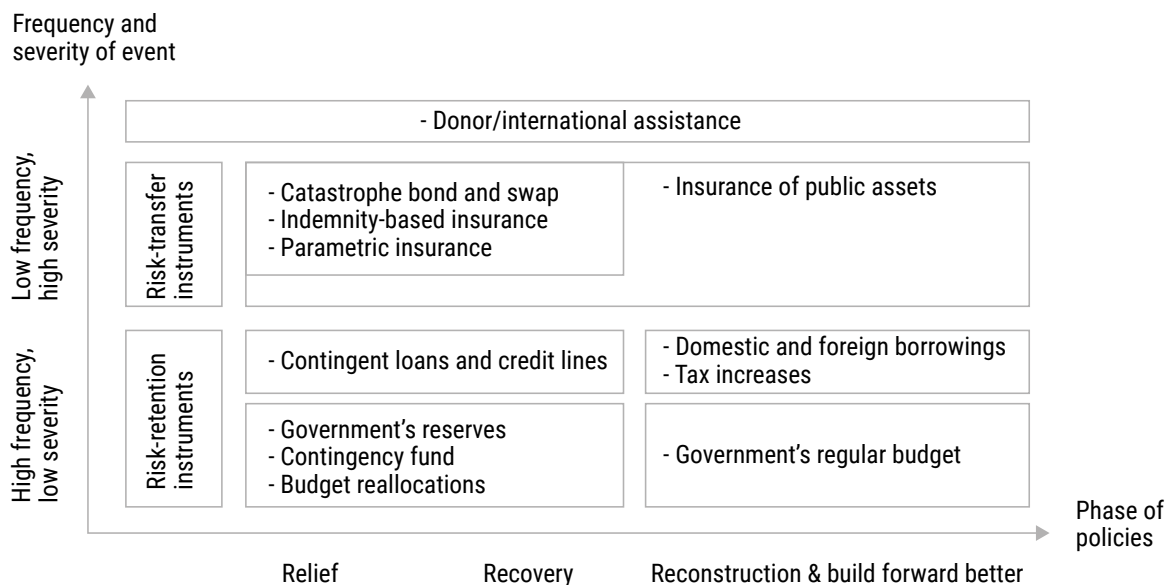
such as overlaps in the scope of use of reserve funds and limited budget execution capacity for disaster response, pose another challenge.

**Hence, financing modalities and instruments should be mixed and matched with catastrophic risks.**

Choosing a financing instrument involves a risk-layering approach, which is often used in the context of climate and disaster risks (figure 5.10). Such a choice should highlight three messages. *First*, for frequent catastrophes and those with limited impact, such as seasonal floods, countries could rely on such instruments as government reserves, contingent funds and budget reallocation. *Second*, for less frequent catastrophes and those with larger impacts, such as nationwide floods, contingent loans and credits could be used during the relief and recovery phases. For instruments mentioned so far, Governments

**Figure 5.10**

### Different types of shocks require different financing instruments and modalities



Source: ESCAP, adapted from ADB and World Bank (2017), Cummins and Mahul (2009), Ghesquiere and Mahul (2010), and Haraguchi and Lall (2019).

retain much of the catastrophic risks, so they primarily bear the cost of policy response. *Third*, for occasional catastrophes that have large impacts, such as earthquakes and pandemics, countries should explore instruments in which sovereign catastrophic risk is partially or wholly transferred to other entities, such as private investors. Examples of such instruments, which are arranged prior to shocks, are catastrophe bonds, swaps and insurance.

### 6.1. Risk-retention financial instruments: ensuring ample fiscal buffer

**Asia-Pacific countries have established national and subregional emergency funds to cope with shocks.** For natural disasters, there are dedicated national reserve funds in such countries as Fiji, Myanmar, Pakistan, Solomon Islands, Tonga and Tuvalu. In response to the COVID-19 pandemic, Australia has set up a \$1 billion fund to support highly affected regions and industries.<sup>3</sup> At the subregional level, the region recently introduced two emergency funds. *First*, the South Asian Association for Regional Cooperation launched the COVID-19 Emergency Fund in March 2020. As of April, the combined contribution from the member countries stood at \$21.6 million.<sup>4</sup> *Second*, South-East Asian countries agreed in April 2020 to set up the ASEAN COVID-19 Response Fund to help secure necessary medical supplies for immediate response and prevention.

<sup>3</sup> For details, see [www.regional.gov.au/regional/programs/covid-19-relief-and-recovery-fund.aspx](http://www.regional.gov.au/regional/programs/covid-19-relief-and-recovery-fund.aspx).

<sup>4</sup> For further information, see SAARC Disaster Management Centre, available at <http://covid19-sdmc.org/covid19-emergency-fund>.

**Governments in Asia and the Pacific have also reoriented existing spending and earmarked additional funds to cope with the pandemic.** Among others, India announced in March 2020 a budget reallocation of \$650 million. China issued a budget notice to ensure prompt budget funding, increased central budget transfers to provinces and encouraged insurance funds to make advance payments to health facilities. The key issue here is to *ensure a balance between flexibility* (quick disbursement of funds to the frontlines) *and accountability* (proper documentation and systems to track expenditures).

### 6.2. Risk-transfer financial instruments: an unfinished agenda

**Several Asia-Pacific countries have introduced insurance to address climate and disaster risks.** In total, the region has more than 50 risk insurance schemes (Chakrabarti, 2020). Examples include schemes for public assets in Indonesia and Viet Nam; agricultural insurance in India, Bangladesh and Mongolia; and earthquake insurance in China and Kazakhstan. Beyond national initiatives, Asia-Pacific countries also participate in subregional catastrophe risk pool initiatives, such as disaster risk insurance facilities to cover losses in Pacific islands and South-East Asia.

**Despite the growing number of catastrophe insurance schemes, their scope and capital adequacy remain limited.** The scope of these insurance schemes is often limited to few risks of disasters and specific categories of damage and losses. The size of the fund is also inadequate. For example, in China and Turkey, only 4 per cent of losses are covered by catastrophe risk insurance schemes (Chakrabarti, 2020). Moreover, the penetration rate of disaster risk insurance is low at only 3 per cent of overall assessed risks of disasters in the region.

**The use of catastrophe bonds is even less common than catastrophe insurance.** At the global level, one example is the World Bank's health pandemic bonds issued in 2017. As of September 2020, the entire \$195.8 million insurance payout agreed in the case of the coronavirus pandemic was transferred to 64 eligible countries worldwide. In total, 17 Asia-Pacific countries received the combined amount of \$70.8 million, with Afghanistan, Bangladesh, Pakistan, Myanmar and Viet Nam being among the larger beneficiaries. Despite its benefits, there are concerns over delays in payout. Options to speed up the payout include relaxing the stringency of the



activation criteria (Gross, 2020) and basing the decision to release funds on stakeholder consultations rather than on the risk modelling alone (Erikson and Johnson, 2020; Zhu, 2020).

**Regional cooperation can enhance the role of emergency financing mechanisms.** Such cooperation is important because the concept of risk sharing works better when the pool of participants is larger and more diverse. For disaster risks, several political forums in Asia and the Pacific have supported the idea of joint solutions, which can go beyond financing to include policy dialogues and knowledge-sharing activities (World Bank, 2017; ESCAP, 2018d). Yet, an important feature of a successful regional approach to emergency financing is to recognize diversity in country-level situations. For example, while potential losses in richer countries could concentrate on public infrastructure and manufacturing facilities, poorer economies suffer more from losses in agriculture and rural housing than in other sectors.

## 7. Boosting Sustainable Development Goal investments by public institutional investors: untapped potential

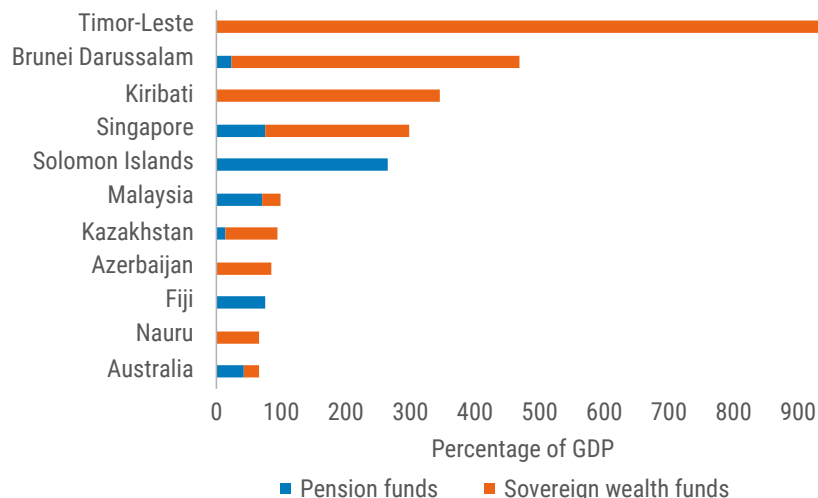
We now turn to a class of investors which can help increase investments in sustainable development: institutional investors, which are generally defined as organizations which pool funds from other entities to make financial investments. Different types of institutional investors have different

investment strategies based on their fiduciary duties and risk tolerance level. Here, we focus on pension funds and sovereign wealth funds, which are often public or quasi-public in nature.

**There is large potential to increase sustainable investments by public institutional investors.** *First*, the assets of pension funds and sovereign wealth funds in Asia and the Pacific are very large, at about \$7.6 trillion in 2019. Primarily driven by resource revenues, these assets in such countries as Brunei Darussalam, Kiribati and Timor-Leste are sizeable relative to their GDP (figure 5.11). *Second*, institutional investors have demonstrated keen interest in contributing to the achievement of the Sustainable Development Goals. In a survey of 175 Asia-Pacific institutional investors, the share of respondents who did not believe in sustainable investments fell from 23 per cent in 2017 to only 10 per cent in 2019 (Schroders, 2019). *Finally*, the COVID-19 pandemic not only piques

Figure 5.11

**Assets of public institutional investors in some Asia-Pacific countries are tremendous in size**



Source: ESCAP, based on OMFIF (2020).

interest on sustainability among institutional investors (FTI Consulting, 2020; See Tho, 2020), but the low interest rate environment also means that fund managers may need to explore alternative, higher-yield asset classes.

**Despite the large potential, the contribution of institutional investors to sustainable development appears limited.** For example, in the world's major pension markets, up to three quarters of their total portfolio is invested in liquid assets compared with less than 3 per cent in infrastructure projects (United Nations, 2017b). Similarly, institutional investors accounted for only 1 per cent of investment in infrastructure projects under public-private partnerships in low- and middle-income countries in 2015 (World Bank, 2016).

**Corporate cultures and rules explain limited sustainable investing.** *First*, staff compensation packages may incentivize investment managers to prioritize short-term performance over long-term goals (Gottschalk and Poon, 2018). For example, according to a survey by Aviva (2014), while 60 per cent of pension funds are of the view that the key investment period is longer than a year, up to two thirds of them review fund managers' performance on a quarterly basis. *Second*, many institutional investors lack in-house expertise to assess the risks of complicated projects, such as cross-border infrastructure projects. *Third*, certain investment regulations limit investments in asset classes, such as infrastructure, that could contribute to sustainable development. *Finally*, certain fiduciary rules and a home bias in investment

decisions, especially among institutional investors in more developed markets, often reduce investments in foreign countries.

### **7.1. Amending investment policies and rules: unleashing funds for development**

**Investment rules governing pension funds are constraining their ability to invest sustainably.** According to OECD (2020a), certain countries, such as Armenia, Georgia, India, Kazakhstan, Pakistan, the Republic of Korea and the Russian Federation, do not allow pension funds to invest in domestic equities or allow but with maximum limits and/or only in equities listed in home or developed markets. For sovereign bonds, most of these countries also impose maximum portfolio limits. For corporate bonds, often there are requirements to invest only in bonds with certain ratings or those with State guarantees. For foreign investments, portfolio limits are, as expected, more restrictive. For example, pension funds in India and Indonesia are not allowed to invest in foreign equities and bonds.

**Relaxing some of these investment rules can channel more financial resources into sustainable development.** As of early 2021, sovereign credit risk ratings in at least 18 developing Asia-Pacific economies are below investment grade, while several other economies are unrated. As a result, corporate and project bonds in these countries are typically non-investment grade because sovereign bonds usually carry the highest rating in the countries. Thus, when institutional investors can invest only in investment grade securities, bonds issued by firms that promote sustainable development in these countries will miss financing opportunities. Meanwhile, the partial relaxation of foreign investment rules can also mobilize sizeable financial resources for other developing countries. For example, if only 1 per cent of assets managed by pension funds in India could be invested overseas, this would amount to 1.5 times the size of foreign aid that its neighbouring country Nepal received in 2018.

**Adjustments in investment policies of sovereign wealth funds could also mobilize additional financial resources for sustainable development.** For example, take the case of Azerbaijan's State Oil Fund. As of October 2020, the Fund's assets stood at \$43.2 billion, or about 86 per cent of the country's GDP in 2019.<sup>5</sup> The portfolio is oriented towards fixed-income and money market instruments and developed

5 For further information, see [www.oilfund.az/en](http://www.oilfund.az/en).

countries (figure 5.12A). While about a third of the Fund's investments are in emerging economies, they appear to be large economies with a strong credit rating, as only 1 per cent of its fixed-income investments is in non-investment grade securities (figure 5.12B). Also, most fixed-income instruments held by the Fund have a maturity of less than three years, which is less well suited to long-term development projects. In essence, adjustments in investment policies that allow larger investments in countries and financial instruments with higher risks would raise sovereign wealth funds' contribution to sustainable development, although the impact of such investments on portfolio risk should be carefully reviewed at the same time.

**A certain amount and share of investments could be allocated directly to sustainable investments through regulatory changes.** In Europe, institutional investors set the amount of funds that they would invest in sustainable investments (Phenix Capital Group, 2017). In Japan, the Government Pension Investment Fund, the world's largest pension fund, allocates a certain share of its investments to environmentally and socially responsible investments. This resulted in more than 300 per cent growth in Japan's sustainable financial assets between 2016 and 2018 (Bray and Moon, 2019).

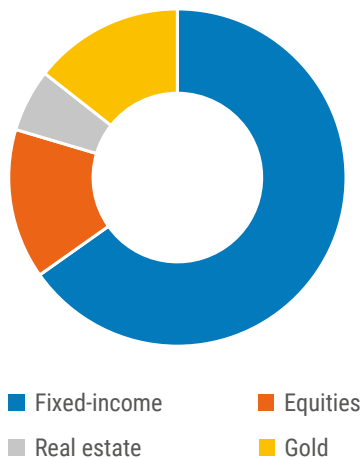
## 7.2. Sustainable investing: integrating sustainability into daily decisions

**Asia-Pacific public institutional investors should step up the use of more active environmental, social and governance (ESG) strategies.** Such strategies as impact investing, direct engagements with companies and full ESG integration into investment decisions tend to have a greater impact on sustainable development compared with passive strategies, such as negative screening (e.g. when firms avoid investing in sectors that are deemed environmentally harmful) (Schlafer, Hobisch and Cavalli, 2020). A recent survey showed that, while 56 per cent of the sample institutional investors from the Asia-Pacific region were already mainstreaming ESG factors into investment processes, that ratio was below 70 per cent for European respondents (Schroders,

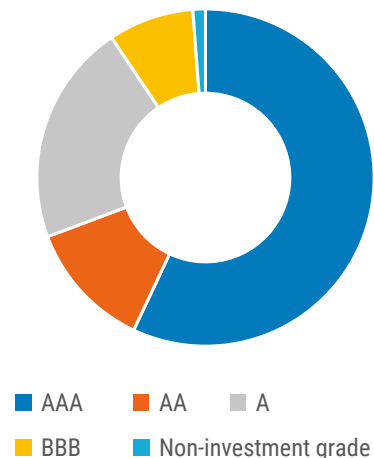
Figure 5.12

### Azerbaijan's State Oil Fund invests primarily in investment grade fixed-income instruments

A. Investment portfolio breakdown



B. Breakdown of fixed-income investment by credit rating



Source: State Oil Fund of the Republic of Azerbaijan.

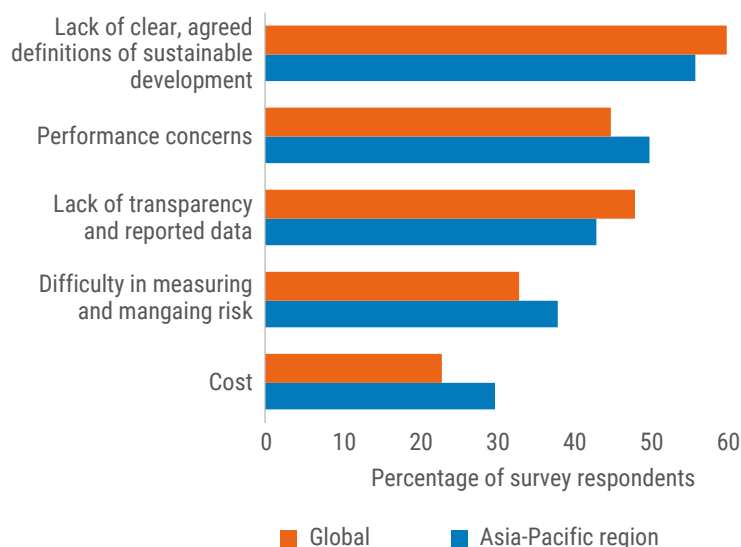
2019). Moreover, together with ESG integration, negative screening remains the most popular ESG strategy in the region.

**Various actions can be taken by institutional investors to pursue more active environmental, social and governance strategies.** Among others, a revision in corporate investment guidelines can facilitate such a shift. For instance, Thailand's Government Pension Fund introduced new guidelines in 2019 that adopted ESG criteria across all investments (GIIN, 2020). Another factor is solid technical capacity of investment teams, which is required to prepare complex investment analyses, such as quantitative investment models that feature ESG scores. However, nearly 40 per cent of surveyed institutional investors in the region face difficulty in measuring and managing risks when investing in sustainable development (figure 5.13).

**Financial market regulators can also play an important role.** For institutional investors to effectively incorporate ESG criteria into their investment decisions, an obvious prerequisite is accurate, consistent and regular sustainability reporting by investees. Indeed, the lack of agreed definitions of sustainable development (figure 5.13) and the transparency of companies' performance reporting (Schroders, 2020) are often rated by Asia-Pacific institutional investors as the main

**Figure 5.13**

**Unclear definitions of sustainable development are the main challenges for sustainable investing**



Source: ESCAP, based on Schroders (2020).

obstacles to sustainable investing. In this regard, financial sector regulators should seek to ensure common ESG definitions and standards and provide incentives for or legally require ESG reporting by firms. Policy effort on this front could be stepped up. For example, only 6 of 18 Asia-Pacific stock markets require ESG reporting as one of their listing requirements (Sustainable Stock Exchanges Initiative, 2018).

## 8. Conclusions

To meet immediate financing needs, cope with larger fiscal deficits and public debt stocks, and achieve sustainable development amid settings with limited fiscal resources, this chapter explored several fiscal and financing policies. Some specific policy recommendations for Asia-Pacific countries with different income levels and multilateral development partners are shown in table 5.1.

**Table 5.1**

**A snapshot of recommended fiscal and financial policy actions**

Policy area	Less developed Asia-Pacific countries	Emerging Asia-Pacific economies	Multilateral development partners
<b>Debt service suspension</b>	As debtors, actively engage in debt relief initiatives with official bilateral and multilateral creditors	As creditors, consider debt service suspension and debt stock reduction	<ul style="list-style-type: none"> <li>• Broaden the scope of debt service suspension</li> <li>• Urge private creditors to participate in debt relief efforts</li> <li>• Create a multilateral debt architecture to facilitate multi-stakeholder debt negotiations</li> </ul>
<b>Offshore sovereign bonds</b>	<ul style="list-style-type: none"> <li>• As issuers, explore offshore public bonds in neighbouring countries with strong economic ties</li> <li>• Improve sovereign credit risk rating</li> </ul>	As host markets, introduce enabling investment rules for cross-border bond sales	Promote common market practices and conditions for cross-border bond issuances
<b>Diaspora bonds</b>	<ul style="list-style-type: none"> <li>• As issuers, conduct a demand analysis to assess the willingness and ability of the diaspora in bond investment</li> <li>• Offer diversity in diaspora bond structure</li> <li>• Further develop domestic capital markets</li> </ul>	<ul style="list-style-type: none"> <li>• As destination economies, facilitate the outreach of bond sales</li> <li>• As issuers, explore diaspora bonds that are sustainability-oriented</li> </ul>	Offer technical assistance to understand regulatory requirements in destination economies
<b>Debt swaps for development</b>	<ul style="list-style-type: none"> <li>• Explore debt swaps with official bilateral and multilateral creditors</li> <li>• Conduct technical feasibility to ensure that agreements increase fiscal space</li> </ul>	<ul style="list-style-type: none"> <li>• As creditors, negotiate debt swaps for development with debtors</li> <li>• As debtors, explore debt swaps with commercial creditors</li> </ul>	<ul style="list-style-type: none"> <li>• Provide technical assistance to prepare feasibility study</li> <li>• Serve as donor to reduce counterpart payments by debtor countries</li> <li>• Prepare guidelines on general terms and conditions of swap arrangements to reduce transaction costs</li> <li>• Minimize fund fungibility in both creditor and debtor countries</li> </ul>

Policy area	Less developed Asia-Pacific countries	Emerging Asia-Pacific economies	Multilateral development partners
<b>Public debt management</b>	<ul style="list-style-type: none"> <li>• Ensure transparent debt reporting</li> <li>• Promote separate, accountable public debt management offices</li> <li>• Strengthen fiscal-monetary policy coordination</li> </ul>	<ul style="list-style-type: none"> <li>• Same as less developed countries, plus promote medium-term debt management strategies that include risk assessments due to contingent liabilities and public-private partnership projects</li> </ul>	<p>Provide technical assistance to increase debt reporting transparency and improve risk assessments</p>
<b>Emergency financing mechanisms</b>	<ul style="list-style-type: none"> <li>• Incorporate sovereign catastrophic risks into Government's financial planning</li> <li>• Ensure adequate reserve funds for recurring disasters</li> <li>• Explore the use of risk-transfer financial instruments for emergencies</li> </ul>	<ul style="list-style-type: none"> <li>• Increase the scale and scope of risk-transfer instruments, including for public assets</li> </ul>	<ul style="list-style-type: none"> <li>• Provide emergency supports in cases of large-scale shocks</li> <li>• Coordinate regional emergency funds</li> <li>• Set up more regional sovereign catastrophe risk-sharing initiatives</li> </ul>
<b>Increase sustainable investing by public institutional investors</b>	<ul style="list-style-type: none"> <li>• For pension funds, relax restrictions on investments in domestic equities and government and corporate bonds</li> <li>• For sovereign wealth funds, allocate part of investment for domestic development projects</li> <li>• Increase awareness of sustainable investing</li> </ul>	<ul style="list-style-type: none"> <li>• Relax restrictions on foreign investments and investments in non-investment grade yet Sustainable Development Goals-oriented securities</li> <li>• For institutional investors, adopt more active ESG investment strategies and enhance technical capacity</li> <li>• For financial regulators, encourage or require ESG reporting</li> </ul>	<ul style="list-style-type: none"> <li>• Reach common definitions and reporting standards of sustainable investing</li> </ul>

Source: ESCAP.



**Beyond these specific policy recommendations, we offer three broad concluding remarks.** *First, to build forward better together, multilateral cooperation not only matters but also is essential.* The full potential of fiscal and financial policies discussed in this chapter can only be realized when Asia-Pacific countries and their international development partners work closely together, as creditors and debtors, investors and investees, and guarantors and beneficiaries.

*Second, while this chapter examined several fiscal and financing policy options to build forward better, options available to Governments in Asia and the Pacific are vast and diverse.* They need to carefully consider the instruments and modalities that leverage a country's strengths, make sizeable benefits relative to efforts needed and are implementable given their institutional capacity.

*Third, amid shrinking fiscal space, the private sector needs to step up its contributions to more resilient, equal and green development.* To make asset owners and managers, financial institutions and corporations become more sustainability-oriented, Governments and financial sector regulators have both incentive- and regulation-based tools at their disposal.





# Chapter 6

## Towards a Resilient Future

The social and economic scars from the COVID-19 pandemic could remain with us long after the recovery from it. Nevertheless, a valuable lesson has been learned – the prevalent development paradigm, focused primarily on short-term economic growth and unmindful of its social and environmental costs, cannot deliver the ambitious 2030 Agenda for Sustainable Development (chapter 1). A fundamental rethink is thus needed.

As explained in the preceding chapters, it is high time for Asia-Pacific policymakers to step up investments in laying resilient foundations of economies that serve the well-being of the people and the planet. It is no longer possible to view human progress as involving a trade-off between material prosperity and its social and environmental consequences. The initial policy responses to the pandemic in the region were, understandably, focused on mitigating its immediate harmful impacts on human health and livelihoods. As brought out in chapter 4, such policy responses are not necessarily effective in strengthening resilience to future shocks.

### **Navigating the complex risk landscape while building forward better**

The *Survey for 2021* draws lessons from past crises caused by economic and non-economic shocks in the region and finds that their long-lasting adverse impacts on people, prosperity and the planet are linked to a failure to integrate risk buffers in development planning and policymaking (chapter 3). A major reason for this is the compartmentalization of policymaking in economic, social and environmental silos, ignoring the essential interconnectedness of all three dimensions of sustainable development. The far-reaching effects of the COVID-19 pandemic are again a reminder that such a siloed approach is simply not suitable for coping



with systemic shocks in the twenty-first century. In particular, in the face of climate change, society can no longer consider “economic” and “environmental” shocks separately. A more holistic approach to development and risk management is needed. Such an approach should be part of policymakers’ thinking as they strive to build forward better both economies and societies.

### **Investing in people and the planet, and reducing the opportunity divides**

A key lesson from the COVID-19 pandemic is that pre-existing vulnerabilities can amplify the effects of shocks and delay recoveries. Poorer countries and more vulnerable groups were more severely affected by the socioeconomic shocks of the pandemic. Moreover, the lack of adequate and equal access to health care and social protection, an international divide in the speed of COVID-19 vaccine roll-outs and unequal opportunities in the post-pandemic adaptations and transitions may drive divergence between advanced and developing countries and between the rich and the poor, resulting in a K-shaped recovery, producing further damage to long-term development prospects (chapter 2).

To avoid such potential outcomes, the *Survey for 2021* proposes an illustrative policy package of basic social services, access for all to digital technologies and stronger climate and clean energy actions (chapter 4):

- Universal access to health-care services and a social protection floor;
- Closing the digital divide;
- Improving energy efficiency, building climate-resilient infrastructure and preserving biodiversity.

A detailed data-oriented analysis of such a “*building forward better*” package shows that it can bring about significant and durable socioeconomic and environmental improvements in the region. Further, there is good news – this is mostly affordable. Yet, to minimize the risk of public debt distress resulting from meeting the large fiscal needs for implementing this package in some less developed Asia-Pacific countries, the *Survey for 2021* also identifies potential sources of financing (chapter 5).

### **Building resilience requires a partnership of all stakeholders**

Above all, the pandemic has demonstrated that a partnership of stakeholders at the local, national, regional and global levels is essential to build an inclusive, green and resilient future. As made clear in the *Survey for 2020*, which highlighted the theme of “*Towards sustainable economies*”, the business-as-usual approach is no longer an option, but building a stakeholder economy can pave the path towards a sustainable future. Similarly, every part of society will have to be a stakeholder in building resilience. This will reflect the true ethos from the region that may be expressed succinctly as “the world is one family”.<sup>1</sup>

<sup>1</sup> Vasudhaiva Kutumbakam.

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United Nations publication  
Sales No. E.21.II.F.5  
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ISBN: 978-92-1-120823-8  
e-ISBN: 978-92-1-604057-4  
ST/ESCAP/2942

United Nations  
Economic and Social Commission  
for Asia and the Pacific (ESCAP)  
Macroeconomic Policy and Financing  
for Development Division  
United Nations Building,  
Rajadamnern Nok Avenue  
Bangkok 10200, Thailand  
Fax: 662 288-3007

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Email: [escap-mpdd@un.org](mailto:escap-mpdd@un.org)  
Website: [www.unescap.org](http://www.unescap.org)

The Asia-Pacific region's recovery from its weakest economic performance in recent history remains fragile and could be "K-shaped" due to the likely unevenness of the COVID-19 vaccine roll-out, policy space and structural weaknesses across the region.

The Asia-Pacific region is no stranger to crises which leave behind severe social and economic impacts. But a better understanding of the complex risk landscape and a comprehensive approach to building resilience have both become imperative in the wake of the COVID-19 crisis. Building resilience into policy frameworks and institutions requires aligning fiscal and monetary policies, and structural reforms, with the 2030 Agenda for Sustainable Development.

The *Economic and Social Survey of Asia and the Pacific 2021* proposes an illustrative "building forward better" policy package for resilient post-COVID-19 economies that is aimed at ensuring universal access to health care and social protection, closing the digital divide and strengthening climate and clean energy actions. Estimated to reduce the number of poor in the region by almost 180 million people and cut carbon emissions by about 30 per cent in the long run, these policy actions need not necessarily add much fiscal burden for most, except for some less developed countries in Asia and the Pacific. It also examines policy options to meet immediate and medium-term financing needs for building resilience, including debt service suspensions, debt swaps for development, sovereign bond financing, public debt management, emergency financing mechanisms and sustainable investing by public institutional investors.

*"As we navigate our way out of this shock, the policy choices we make now should be green, just and sustainable in order to build long-term resilience and reduce the severity of future shocks."*

**António Guterres**

Secretary-General of the United Nations

21-00224



ISBN 978-92-1-120823-8

