At the (…) Rio+20 United Nations Conference on Sustainable Development in 2012, world leaders pledged to adopt forward-looking macroeconomic policies that promote sustainable development and lead to sustained, inclusive and equitable economic growth (…) The Economic and Social Survey of Asia and the Pacific 2013 makes it clear that such investments are not only essential but also affordable.

Half a decade since the onset of the Great Recession, the Asia-Pacific region continues to anchor the global economy, but its rate of economic growth remains subdued compared to the pre-global financial crisis period. It is also showing signs of strain, as uncertainty and crisis deepen in the United States and the euro zone. More importantly, the Asia-Pacific region’s growth path continues to leave behind hundreds of millions and to put unsustainable pressure on the natural resource base.

The 2013 edition of the Economic and Social Survey of Asia and the Pacific argues that macroeconomic policies can play a key role not only in supporting the economies of the region in the short term, but also in reorienting the region towards a more inclusive and sustainable pattern of development. By carefully designing short-term support measures, it is possible to sustain growth as well as address long-term structural issues.

As an illustrative example, the Survey 2013 estimates, for a number of Asia-Pacific countries, the public investment needs required to deliver a package of policies to sustain growth and to promote inclusive and sustainable development. The policy package comprises a job guarantee programme, a universal pension scheme, disability benefits, increased public health spending, universal school enrolment and universal access to modern energy.

The Survey finds that most countries can finance such a package without jeopardizing macroeconomic stability, although least developed countries would also require global partnership and development cooperation. The analysis underlines the need to move forward the regional development agenda from a discussion on the future we want to the means of implementation to realize that future.
ESCAP is the regional development arm of the United Nations and serves as the main economic and social development centre for the United Nations in Asia and the Pacific. Its mandate is to foster cooperation between its 53 members and 9 associate members. ESCAP provides the strategic link between global and country-level programmes and issues. It supports Governments of countries in the region in consolidating regional positions and advocates regional approaches to meeting the region’s unique socio-economic challenges in a globalizing world. The ESCAP office is located in Bangkok, Thailand. Please visit the ESCAP website at www.unescap.org for further information.

The shaded areas of the map indicate ESCAP members and associate members.

Cover photo by Geoffrey Métiais

Cover design by Marie Ange Sylvain-Holmgren
While the Asia-Pacific region has weathered the financial crisis better than many other parts of the world, there is an urgent need to adapt macroeconomic policies to address the challenges of sustainable development and assist the poorest and most vulnerable.

That means complementing the emphasis on growth with a focus on equality and rights, social development and environmental sustainability. Specifically, it requires investments to address inequality, shortages in energy and inadequate infrastructure.

At the High-level Plenary Meeting of the General Assembly on the Millennium Development Goals in 2010 and the Rio+20 United Nations Conference on Sustainable Development in 2012, world leaders pledged to adopt forward-looking macroeconomic policies that promote sustainable development and lead to sustained, inclusive and equitable economic growth.

Fortunately, many economies in the region are well-placed to implement such policies. The *Economic and Social Survey of Asia and the Pacific 2013* makes it clear that such investments are not only essential but also affordable.

These efforts are especially needed in Least Developed Countries, Landlocked Developing Countries and Small Island Developing States. As well as assisting the achievement of the Millennium Development Goals, greater progress will fuel confidence in, and mobilize support for, an ambitious post-2015 development agenda. The recommendations in this issue of the *Survey* seek to assist these countries to advance economically, socially and environmentally.

I hope the policy-makers of Asia and the Pacific, and beyond, find this publication useful for its innovative approach to achieving more resilient, inclusive and sustainable development.

BAN Ki-moon
Secretary-General of the United Nations

April 2013
The Economic and Social Survey of Asia and the Pacific monitors regional progress, providing cutting-edge analyses and guiding policy discussion on the current and emerging socioeconomic issues and development challenges in the region since 1947. Its 2009 edition argued that the global economic and financial crisis could be turned into an opportunity to jump-start a regional reorientation towards a more inclusive, equitable and sustainable development path. While many Asian and Pacific countries started to take steps towards that goal, the recovery of economic growth since 2010, even if it is below the pre-crisis period, may dampen the sense of urgency about the need to reorient the region’s development pattern.

The 2013 Survey reminds us that this is no time for complacency, as the need for a more inclusive and sustainable pattern of economic and social development continues to be critical. The Survey comes at a crossroad for Asia and the Pacific because of the tensions within the current development pattern of the region exposed by the ongoing crisis in the global economy, environmental fragilities, rapid demographic shifts and resource constraints.

As much as the region anchors the global economy, it is still home to more than 800 million people living in extreme poverty, 563 million people undernourished and more than 1 billion workers in vulnerable employment, while income and social inequality and economic insecurity continue to increase in many countries. In addition, the high resource-intensity of economic growth has caused a rapid rise in emissions of greenhouse gases and made countries increasingly vulnerable to commodity price shocks. The hundreds of millions left behind, along with the unsustainable pressures on natural resources, call – loud and clear – for a fundamental shift in the region’s development journey.

The good news is that Asia and the Pacific has already started to rethink and reinvent itself. It is doing so by looking for new drivers of economic growth, closing development gaps and seeking to rebalance export-led growth with a greater reliance on domestic demand. It is also increasing spending on health, education, social protection and disaster management and it is addressing deficits in infrastructure and sustainability, including through low carbon and green economy policies. These
efforts should be supported, enhanced and propagated throughout all countries in the region. However, a major concern of policymakers about implementing a new, bold agenda is how much will it cost.

The main contribution of this edition of the Survey is to provide an answer to that important concern. It does so by estimating the required public expenditures for an illustrative package of policies to promote inclusive and sustainable development in a number of Asia-Pacific countries. The package includes the provision of an employment guarantee for 100 days a year, basic social services in education and health, income security to older persons and persons with disabilities and ensuring efficient energy for all.

The results are highly encouraging. They show that most countries can finance such a package without jeopardizing macroeconomic stability, although least developed countries would also require global partnership and development cooperation. To be sure, the package proposed in the 2013 Survey is just an illustrative example, and the details of the calculations deserve to be further discussed and refined. The purpose of this exercise is to move forward the regional development agenda from the discussion of the future we want to the means of implementation and financing to realize that future.

The package of policies discussed in this edition of the Survey not only illustrates the feasibility of taking decisive action towards inclusive and sustainable development in Asia and the Pacific but also highlights the importance of macroeconomic policies for this purpose. The dominant macroeconomic policy paradigm since the early 1980s has been too restrictive and not geared towards a great leap forward to inclusive and sustainable development. In the light of the region’s high degree of economic insecurity, large development and infrastructure gaps and heightened environmental fragility along with extreme exposure to climate change-related risks, it is necessary to better balance the stabilization and developmental roles of macroeconomic policies. Macroeconomic policies could and should be forward-looking in order to play a key role in the region’s next great transition to inclusive, resilient, equitable and sustainable development.

We hope that this document will stimulate policy debates among government officials, researchers, development partners and the general public of Asia and the Pacific, and that it will contribute to fostering a more inclusive and sustainable development in the region.

Noeleen Heyzer
Under-Secretary-General of the United Nations and Executive Secretary, United Nations Economic and Social Commission for Asia and the Pacific
Economic growth in the developing countries of Asia and the Pacific slowed to 5.6% in 2012 as a result of the double-dip recession in the euro zone and the tepid recovery of the U.S. economy. Although growth is projected to inch up to 6% in 2013, this rate is still below the average of 7.8% achieved in 2010-2011 and the average of 8.6% observed during the pre-crisis period of 2002-2007. More importantly, the extent to which the region's economic growth is contributing to the achievement of key development goals remains unclear.

Despite a significant reduction in poverty, the region is still home to more than 800 million poor struggling to survive on an income of less than $1.25-a-day. This figure represents nearly two-thirds of the world's poor. Notably, in many countries in the region, including the most populous ones, rapid growth in income since the 1990s has been accompanied by increases in income inequality. In addition, the high resource-intensity of economic growth has spurred a rapid rise in emissions of greenhouse gases and made countries increasingly vulnerable to commodity price shocks, while key natural resources, such as forest covers, fisheries and fresh water, have been overexploited.

Economic insecurity has also risen amid rapid growth. More than 1 billion workers in the region are in vulnerable employment – characterized by low wages, no benefits, no job security and difficult conditions of work that undermine workers’ fundamental rights. More than 900 million people in the region live just at the edge of extreme poverty on an income of between $1.25-a-day and $2-a-day, with the risk of a small shock or personal misfortune pushing them into extreme poverty in the absence of a comprehensive social protection floor.

Food security is also a major problem in Asia and the Pacific, with an estimated 563 million people undernourished. Economic insecurity and vulnerability are exacerbated by increasingly damaging natural disasters, which many believe are related to climate change and environmental degradation. Notably, during the period 1970-2010, the average number of people exposed to yearly flooding in Asia more than doubled from 29.5 million to 63.8 million while the population residing in cyclone-prone areas increased from 71.8 million to 120.7 million. In sum, despite the region's rapid economic growth, hundreds of millions of people continue to be highly vulnerable and insecure. Economic expansion has not been inclusive enough and has not translated into increased security of jobs and livelihoods. Instead, growth has been mostly jobless, that is without a commensurate growth of decent and productive employment in the formal sector. As a result, livelihood insecurity and disparities of opportunities and outcomes, including income, assets and wealth, are on the rise and reinforcing one another.
These trends, however, are not inevitable. The historical experience of successful economies in the Asia-Pacific region shows that rapid economic growth is not incompatible with a broad-based dissemination of opportunities for progress across the population, as elaborated in chapter 3. Enhancing the resilience of peoples' livelihoods and the inclusiveness of the development process is possible and must be a priority of the development agenda beyond 2015 for the Asia-Pacific region. This edition of the Survey argues that macroeconomic policies, especially fiscal policies, could and should play an instrumental role in achieving this priority.

Making development more inclusive and sustainable can help support growth

Inclusive and sustainable development can contribute to supporting broad-based economic growth in the region by stimulating domestic sources of aggregate demand, which can have beneficial spillover effects across the region through trade. This edition of the Survey estimates that the effort of China to rebalance its economy towards a more pro-poor and consumption-led pattern of development could spur an additional $13 billion worth of exports from other countries in the region during the period 2013-2015, representing an additional 0.5 of a percentage point to the region's rate of growth of exports.

The setting of minimum wages is another policy that can contribute to both addressing rising income disparities and supporting aggregate demand. The Survey argues that a minimum wage policy, if it is designed carefully and contains supportive adjustment measures, boosts workers' productivity and income and improves long-term job prospects without adversely affecting businesses. For example, it is estimated that the recent increases in minimum wage in Thailand could increase employment growth by up to 0.6 of a percentage point and real GDP growth by 0.7 of a percentage point by 2015 compared to a baseline scenario of no minimum wage increase.

In addition to demand policies, making the development process more inclusive and sustainable calls for supply-side policies to remove structural impediments to growth such as energy shortages and inadequate infrastructure. Supply-side policies aimed at reducing the carbon intensity of growth are also needed to minimize adverse impacts of economic activity on natural resources and commodity prices. The agricultural sector plays a fundamental role as a producer of food and employer of approximately 60% of the working population in the region, including the majority of the poor. After decades of neglect, the sector deserves special attention, especially in the light of challenges emanating from a growing population and an increased incidence and intensity of extreme weather events.

The implementation of both demand-side and supply-side policies towards inclusive and sustainable development relies fundamentally on the ability of States to allocate public spending – and to create a conducive environment for private investments – in key economic and social sectors of the economy. This requires broad-based forward-looking macroeconomic policies that balance stabilization and development needs.

The role of macroeconomic policies

The dominant macroeconomic policy paradigm since the early 1980s has emphasized stabilization in the narrow sense of keeping inflation at a very low single-digit level and achieving a primary budget surplus or a very low deficit-to-GDP ratio. In developing countries, there often has been a trade-off between achieving such stabilization targets and broader development objectives. Many countries have achieved them at the cost of development, for example, by cutting public investment in key areas and expenditures
on education and health. Indebted countries in the euro zone are also prioritizing fiscal austerity at an enormous economic and social cost associated with high unemployment.

While keeping inflation and the fiscal accounts under control are important objectives of macroeconomic policy, disregarding important development objectives could be highly detrimental for an economy’s long-term prospects. In the light of the extensive development challenges of Asia and the Pacific associated with the region’s high degree of economic insecurity, large development gaps, significant infrastructure shortages and unsustainable environmental impacts, there is clearly a need to balance the stabilization and developmental roles of macroeconomic policies.

Such balance could entail changing the way fiscal and monetary policies are designed and implemented, and how issues pertaining to public debt or inflation are viewed. In particular, as argued in previous editions of the Survey, there has to be greater emphasis on the quality and composition of public expenditure, rather than on aggregate budget deficits and public debts. The present Survey further develops this theme by providing estimates of the required public investment for a set of policies to enhance the region’s resilience and inclusiveness in selected countries. These policies include the provision of an employment guarantee for a limited number of days (100 days) in a year, basic social services in education and health, income security to older persons and persons with disabilities and ensuring energy for all by 2030.

These policies are examples of forward-looking macroeconomic policies because they can promote sustainable development and lead to sustained, inclusive and equitable economic growth. The importance of forward-looking macroeconomic policies has been recognized in key United Nations documents, such as the outcome document of United Nations Conference on Sustainable Development (Rio+20), which was held in Rio de Janeiro, Brazil, from 20 to 22 June 2012. It is expected that the contents of the current Survey will contribute to policy debates about how to realize the goal of inclusive and sustainable development in the Asia-Pacific region.

**Prospects for 2013**

As indicated above, economic growth in the developing Asia-Pacific economies is expected to increase slightly to 6% in 2013 from 5.6% in 2012. The increase is partly due to an expected improvement in global demand arising from steady, although subpar, growth in the United States and a limited rebound in the performance of major emerging economies. The two regional giants, China and India, are expected to rebound somewhat from a slowdown in 2012. China is expected to grow by 8% in 2013, slightly up from 7.8% in 2012, while India is expected to recover from its relatively low 5% growth in 2012 to 6.4% in 2013. Somewhat improved global trade is expected to support growth in export-led economies, such as the Republic of Korea (from 2% in 2012 to 2.3% in 2013), Hong Kong, China (from 1.4% to 3.5%) and Singapore (from 1.3% to 3%).

Growth in North and Central Asia is likely to remain stable, as the subregion continues to benefit from high global energy prices and sustained growth in the Russian Federation (3.4% in 2012 and 3.6% in 2013). In South and South-West Asia, four countries in addition to India – Afghanistan, Bangladesh, Bhutan and Sri Lanka – are projected to grow by 6% or more in 2013. In contrast, most Pacific island developing economies are expected to experience slower growth in 2013. For example, the rate of growth in Papua New Guinea is expected to drop to 4% in 2013 from 9.2% in 2012 as a result of the winding down of a large liquefied natural gas construction project.
Investing in inclusive and sustainable development

The current issue of the Survey estimates, as an illustrative example, the public investment needs to deliver a package of policies to promote inclusive and sustainable development in 10 Asia-Pacific countries: Bangladesh, China, Fiji, India, Indonesia, Malaysia, Philippines, Russian Federation, Thailand and Turkey. The package includes the following six elements:

- A job guarantee programme that is available to all participants in the informal sector for 100 days per year and pays benefits equivalent to the national poverty line;
- A universal, non-contributory pension for all aged 65 or older valued at the national poverty line;
- Benefits to all persons with disabilities between the ages of 15 and 65 equivalent to the national poverty line;
- Increasing the share of public health expenditures of GDP to 5% by 2030;
- Universal enrolment in primary education by 2020 and in secondary education by 2030; and
- Three energy goals to be achieved by 2030: (i) universal access to modern energy services, (ii) doubling the global rate of improvement in energy efficiency, and (iii) doubling the share of renewable energy in the global energy mix.

The overall investment requirements to implement such a policy package vary across countries, with median values of 5.8% of GDP by 2020 and 8.2% of GDP by 2030. Most of the increase between 2020 and 2030 is due to health expenses – as they are assumed to rise gradually until 2030 – and pensions – due to the increase in the share of the population aged 65 and above. In the case of China, the cost of the package is projected to reach 3.3% of GDP in 2020 and 5.2% of GDP by 2030. For other countries, such as India, Indonesia, Malaysia, the Russian Federation, Thailand, Turkey and Viet Nam, the numbers are projected to vary between 4.7% and 9.8%. While these amounts are not trivial, they are affordable. Because of the low tax revenue-to-GDP ratios prevailing in the region, measures such as broadening tax bases, making tax structures more progressive, improving the efficiency of tax administration and tightening regulations on tax havens could raise the required financing. The cost of the package is projected to exceed 10% of GDP by 2030 only in Fiji (13%) and Bangladesh (22%). This suggests that economies with special needs, such as small island developing states and least developed countries, will need significant external assistance from development partners to complement their domestic resource mobilization efforts.

In addition, a long-term macroeconomic simulation exercise shows that governments can pursue inclusive and sustainable development while maintaining fiscal sustainability and price stability at the same time. This suggests that there is not necessarily a tradeoff between economic growth, social development and environmental sustainability. The three pillars of sustainable development can support and strengthen each other, thus challenging the “grow first” paradigm.

This is very encouraging. It vindicates the importance of rethinking and adopting broad-based forward-looking macroeconomic policies for a win-win development for both people and the planet as recognized by the world leaders at the 2010 Millennium Development Goals Summit and again at the Rio+20 conference in 2012.
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EXPLANATORY NOTES

Analyses in the *Economic and Social Survey of Asia and the Pacific 2013* are based on data and information available up to the end of March of 2013.

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
- **Least developed countries:** Afghanistan, Bangladesh, Bhutan, Cambodia, Kiribati, Lao People’s Democratic Republic, Myanmar, Nepal, Samoa, Solomon Islands, Timor-Leste, Tuvalu and Vanuatu
- **Landlocked developing countries:** Afghanistan, Armenia, Azerbaijan, Kiribati, Kyrgyzstan, Lao People’s Democratic Republic, Mongolia, Nepal, Tajikistan, Turkmenistan and Uzbekistan
- **East and North-East Asia:** China; Democratic People’s Republic of Korea; Japan; Hong Kong, China; Macao, China; Mongolia; and 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:** Pacific excluding Australia and New Zealand
- **Small island developing states:** Cook Islands, Fiji, Kiribati, Maldives, Marshall Islands, Micronesia (Federated States of), Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Timor-Leste, Tonga, Tuvalu and Vanuatu
- **South and South-West Asia:** Afghanistan, Bangladesh, Bhutan, India, Islamic Republic of Iran, 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

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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.

Reference to “tons” indicates metric tons.
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. The ISO codes, fiscal years, currencies and exchange rates as of 31 December 2012 of the economies in the ESCAP region are listed in the following table:

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</tr>
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</tr>
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<td>New Zealand dollar ($NZ)</td>
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<td>United States dollar ($)</td>
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<td>ISO code</td>
<td>Fiscal year</td>
<td>Currency and abbreviation</td>
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<td>dong (D)</td>
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a  30 November 2012.

b  31 October 2012.
ABBREVIATIONS

ADB  Asian Development Bank
AEC  ASEAN Economic Community
APEC  Asia-Pacific Economic Cooperation
ASEAN  Association of Southeast Asian Nations
ASEAN+3  ASEAN + China, Japan and Republic of Korea
ASEAN+6  ASEAN + Australia, China, India, Japan, New Zealand and Republic of Korea
CAL  capital account liberalization
CLMV  Cambodia, Lao People’s Democratic Republic, Myanmar and Viet Nam
CO2  carbon dioxide
CPI  consumer price index
CRED  Centre for Research on the Epidemiology of Disasters
DAC  Development Assistance Committee
DFID  Department for International Development
ESCAP  Economic and Social Commission for Asia and the Pacific
EPOC  ESCAP Pacific Operations Centre
EU  European Union
FDI  foreign direct investment
GDP  gross domestic product
GNI  gross national income
GRB  gender-responsive budgeting
IBRD  International Bank for Reconstruction and Development
IEA  International Energy Agency
ILO  International Labour Organization
IMF  International Monetary Fund
km2  square kilometre
kWh  kilowatt-hour
LAC  Latin America and Caribbean
LDCs  least developed countries
LLDCs  landlocked developing countries
LPG  liquefied petroleum gas
LPI  Logistics Performance Index
MFI microfinance institutions
MW megawatt
NGO non-governmental organization
ODA official development assistance
OECD Organization for Economic Cooperation and Development
PISA Programme for International Student Assessment
PPP purchasing price parity
QE quantitative easing
R&D Research and development
Rio+20 United Nations Conference on Sustainable Development
SAARC South Asian Association for Regional Cooperation
SIDS small island developing States
SMEs small and medium-sized enterprises
SPC Secretariat of the Pacific Community
SPF social protection floor
SRO-SSWA Subregional Office for South and South-West Asia
UNCTAD United Nations Conference on Trade and Development
UNDESA United Nations, Department of Economic and Social Affairs
UNDP United Nations Development Programme
UNESCO United Nations Educational, Scientific and Cultural Organization
UNICEF United Nations Children’s Fund
UNIFEM United Nations Development Fund for Women
UNISDR United Nations International Strategy for Disaster Reduction
WHO World Health Organization
SOURCES OF QUOTATIONS

(a) Page 1: an excerpt from the speech of Prime Minister Sheikh Hasina (the People’s Republic of Bangladesh) at the 18th Biennial Conference of Bangladesh Economic Association, 13 September 2012 (source: www.pmo.gov.bd/index.php?option=com_content&task=view&id=855&Itemid=353)

(b) Page 13: an excerpt from the speech of President Xi Jinping (the People’s Republic of China) at the opening plenary of BFA Annual Conference in his capacity as Vice-President, 11 April 2010 (source: www.english.people.com.cn/90001/90776/90883/6946380.html)


(d) Page 137: an excerpt from the speech of President Vladimir Putin (the Russian Federation) at the meeting with G20 Finance Ministers and Central Bank Governors, 15 February 2013 (source: www.eng.kremlin.ru/transcripts/5007)

The things that ensure people’s welfare, those that are poor-friendly, which boost the country’s economy and those having durability and sustainability should be the subjects of the progressive economists.

Sheikh Hasina,
Prime Minister of the People’s Republic of Bangladesh

The Economic and Social Survey of Asia and the Pacific 2013 comes at a time of continued global economic crisis and growing uncertainty over the economy, the environment and the type of politics or governance arrangements that can lead to equitable, inclusive and sustainable development. In less than a decade after the global community mobilized around the Millennium Declaration with commitments to “make poverty history”, the world was shaken by the worst economic crisis since the Great Depression, which has come to be known as the Great Recession.
The Great Recession of 2008-2009 has exposed the weaknesses of the development paradigm, including the macroeconomic policies pursued since the early 1980s, which resulted in a rise in inequality of income, wealth and opportunities within and among countries. The global interdependence on which shared prosperity was premised had become instead a conduit for inequality, crisis and economic insecurity. Rising and volatile commodity prices, especially of food and fuel, coming on top of the economic crisis, are being exacerbated by extreme weather conditions. The interrelated shocks in food, fuel and financial markets have undermined the already precarious livelihoods of millions of people, threatening the limited progress of previous decades. Financial crises, commodity price volatility and extreme weather conditions seem to have become a “new normal”.

Thus, today’s challenges to economic and social development are now of a magnitude and complexity that was not imagined at the turn of the millennium. Therefore, the new context or “new normal” calls for reframing the development problem, including the thinking of the macroeconomic policy paradigm that focuses not just on return to growth, but also on equality and rights, social development and environmental protection.

It is in this backdrop of acute uncertainty, that the world leaders gathered at the United Nations Conference on Sustainable Development (Rio+20), which was held in Rio de Janeiro, Brazil, from 20 to 22 June 2012, and declared: “We recognize that people are at the centre of sustainable development and in this regard we strive for a world that is just, equitable and inclusive, and we commit to work together to promote sustained and inclusive economic growth, social development and environmental protection and thereby to benefit all”.

They also recognized the importance of job creation by calling for “adopting forward-looking macroeconomic policies that promote sustainable development and lead to sustained, inclusive and equitable economic growth...”. In recognizing the lessons learned and successful policies and approaches in the implementation and achievement of the Millennium Development Goals, the same call was also made in paragraph 23(b) of the outcome document of the 2010 High-level Plenary Meeting of the United Nations General Assembly (commonly known as the MDG Summit).

One might think that the above is not applicable for Asia and the Pacific in the light of the fact that the region is generally regarded as an early achiever of many of the Millennium Development Goals. The region’s unprecedented decline in poverty is the main factor behind the attainment of the Millennium Development Goal of halving the global poverty rate well ahead of the target year, 2015. The Asia-Pacific economies have been the drivers of the global economy, especially since the Great Recession. They showed remarkable resilience to the global economic turmoil, and earlier were able to recover quickly from the major regional financial crisis of 1997-1998.

There is a need to emphasize the inclusiveness of development in the Asia-Pacific region as well as to adopt forward-looking macroeconomic policies for addressing the large development gaps that still exist.

The rapid transformation of some of the Asia-Pacific economies over the past four decades has been unparalleled in the history of economic development. Their transformation defied the pessimism contained in the Asian Drama, the three volume 1968 magnum opus of Nobel Laureate, Gunnar Myrdal (Myrdal, 1968). These rapidly transforming economies have often been described as “miracle economies”. One of the key features of this miracle was shared growth – the ability to achieve rapid growth without deteriorating income inequality – which has not been commonly observed in other parts of the world in the past.
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also appear unnecessary. Furthermore, sustainable development already encompasses social aspects, which, to some observers, would include inclusiveness. However, as elaborated below, there is a need to emphasize this particular aspect of development in the Asia-Pacific region as well as to adopt forward-looking macroeconomic policies for addressing the large development gaps that still exist.

First, in a number of countries the environment, including forest covers, fisheries, and fresh water availability, has taken a big toll as the economies grew rapidly. More importantly, the growth has been highly resource-intensive, especially fossil fuel-intensive, causing not only a rapid rise in emissions of greenhouse gases but also making countries increasingly vulnerable to shocks in the global supply chain and price volatility. Second, despite significant reduction in poverty, the region is still home to more than 800 million poor, accounting for nearly two-thirds of the poor around the world who struggle to survive on an income of less than $1.25 a day. Third, there was “miracle no more”; disappointingly, the rapid growth in income since the 1990s has not benefited the poor as much as the rich, causing income inequality to rise and diminishing significantly the region’s progress in social development.

Economic insecurity has also risen amid rapid growth. More than 1 billion workers in the region, comprising in excess of 70% of the global vulnerable workforce (ILO, 2013), are in vulnerable employment characterized by low wages, no benefits, no job security and difficult conditions of work that undermine workers’ fundamental rights. Food security is also very low: an estimated 563 million people are undernourished (FAO, 2011), and a large number of people are vulnerable to global food price volatility. ESCAP estimates, published in the Economic and Social Survey of Asia and the Pacific 2011 showed that high food prices in 2010 kept an additional 19.4 million in poverty in the region. This comprised 15.6 million who would otherwise have emerged from poverty and 3.8 million who were pushed below the poverty line.

Economic insecurity and vulnerability are exacerbated by increasingly damaging natural disasters, which many believe are related to climate change and environmental degradation. Natural disasters in 2011, including the Great East Japan Earthquake and the South-East Asian floods, caused a staggering $294 billion worth of economic losses in the region, representing 80% of global losses due to disasters in 2011 and largely exceeding the region’s 25% share in the world’s gross domestic product (GDP) (ESCAP and UNISDR, 2012). Human insecurity in the region has also risen. For example, between 1970 and 2010, the average number of people exposed to yearly flooding in Asia has more than doubled from 29.5 million to 63.8 million, and the population residing in cyclone-prone areas has grown from 71.8 million to 120.7 million. Three-quarters of global disaster deaths during the same period have taken place in the Asia-Pacific region (ESCAP and UNISDR, 2012). Nevertheless, the Asia-Pacific economies have bounced back strongly after each major natural disaster, including the 2004 Indian Ocean tsunami and recent earthquakes and severe floods.

Despite resilience to economic crises and natural disasters, there is much vulnerability and insecurity of people

Economic insecurity and vulnerability are particularly high in the region because most Asia-Pacific developing countries lack a comprehensive social protection system to help people regenerate their livelihoods when affected by economic crises, natural disasters or personal misfortunes. In spite of significant progress in recent years in a number of countries, including through the provision of basic health-care access and income support to the poor, public social security expenditure remains low, at less than 2% of GDP in half the countries in the Asia-Pacific region. On average, only 30% of persons above the retirement age in Asia and the Pacific receive a pension, while only 10% of the unemployed receive any benefits (ILO, 2010a).
Thus, despite the remarkable resilience of the Asia-Pacific economies to economic crises and natural disasters, the people living in this region continue to be highly vulnerable and insecure. In other words, there is a disconnect between the resilience of the economies and the resilience of the people in the region as rapid growth and economic recovery have not been inclusive and did not increase security of jobs and livelihoods. Instead, growth has been mostly jobless, that is without a commensurate growth of decent and productive employment in the formal sector. As a result, livelihood insecurity and disparities of opportunities and outcomes, including income and wealth, are on the rise and reinforcing one another, especially in the absence of a decent social protection system.

Therefore, enhancing resilience of livelihoods and the inclusiveness of the development process must be explicitly recognized as key priorities for the Asia-Pacific region when considering the development agenda beyond 2015 and assessing the challenges that lie ahead.

There is a clear need for forward-looking macroeconomic policies that focus on productive and decent employment, human and social development and environmental protection as well as on protecting the development gains in times of crisis, instead of just on inflation and the budget deficit or public debt (see box A). Experience over the past three decades has shown that low inflation and a primary budget surplus may be a necessary but not sufficient condition for enhancing the resilience of people and attaining inclusive and sustainable development.

Forward-looking macroeconomic policies, thus, must promote the provision of "universal access to public and social services" and "social protection floors" in order to make development more inclusive and protect development gains. As the ESCAP 2011 Theme Study, The Promise of Protection: Social Protection and Development in Asia and the Pacific reiterated, “a robust system of social protection not only fulfils people’s basic rights, it also establishes a firm platform for both social and economic development and provides an automatic stabilizer for vulnerable groups affected by crisis”. Therefore, “social protection must not simply be seen as a handout. It is an investment in inclusive growth. It is an investment in human capabilities to get people out of exclusion and poverty and to build resilience to risks and vulnerabilities”.

In the context of the Asia-Pacific region, both resilience and inclusiveness have specific meanings beyond what is generally understood. In particular, as highlighted in the ESCAP 2013 Theme Study, Building Resilience to Natural Disasters and Major Economic Crises, resilience entails not only the ability to steer the economy and sustain growth during economic crises but also protect livelihoods and hence the resilience of people.

Box A. Forward-looking macroeconomic policies

“Forward-looking macroeconomic policies are needed to safeguard the sustainability of public investment strategies in support of broad-based growth and the achievement of the Millennium Development Goals. Macroeconomic policies should not focus narrowly on debt stabilization and curbing inflation, but should ultimately be supportive of growth of real output and employment. It is often necessary, therefore, to relax unnecessarily stringent fiscal and monetary restrictions and to use countercyclical fiscal and monetary policies to boost employment and incomes and to minimize the impact of external and other shocks on poverty. This requires countries to strengthen mobilization of domestic resources and adopt mechanisms that promote countercyclical policy responses. Enhanced international cooperation to strengthen tax revenue collection and increase sovereign debt sustainability can greatly buttress the fiscal capacities of all Governments”.

Source: Report of the Secretary-General A/64/665: Keeping the promise - a forward-looking review to promote an agreed action agenda to achieve the Millennium Development Goals by 2015, para. 50.
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Figure A below contains a schematic presentation of an integrated framework in which the strengthening of social and environmental pillars through the state provision of basic income security and public services to all and investment in environmental protection reinforces the economic pillar and hence helps achieve resilient and inclusive sustainable development. It also recognizes that strengthening the social and environmental pillars has a direct fiscal implication, which, in turn, has a direct macroeconomic impact on, for instance, inflation and debt. This may consequently affect growth. The framework also includes resource mobilization. It is easier to mobilize resources when they are earmarked for socially desirable causes. Moreover, increased access to basic public services, such as improved health and education, as well as greater income security will make growth more inclusive. It will also over time lead to a more productive labour force and thereby to more sustainable growth as the total factor productivity increases, strengthening in turn resource mobilization. As a result, the impacts of such public actions to strengthen social and environmental pillars on public debt and inflation may not be large, and should not destabilize the macroeconomy. Thus, it is a win-win solution.

Box B. Mainstreaming social and environmental pillars for inclusive and sustainable development

Figure A. An integrated framework
Likewise, the inclusiveness of growth and development would mean not only social inclusion and a reduction of inequality of opportunities and income but also a reduction of people’s vulnerability to crises, disasters and misfortune. This is a much broader concept than, for example, pro-poor growth, which targets only a subset of vulnerable people. In this case, the focus is on preventing people from falling back into extreme poverty by helping them regenerate their livelihoods after they are hit by shocks.

Thus, there is a close affinity between resilience and the inclusiveness of the development process. As a result of their interconnectedness, development strategies that are aimed at enhancing resilience and inclusiveness mutually reinforce each other and strengthen both the economic and social pillars of sustainable development.

There is also a feedback loop from environmental sustainability, the third pillar of sustainable development, to both the economic and social pillars, in particular resilience and inclusiveness in their broader sense (see box B). For example, better air quality or an improvement in access to better sanitation leads to better health, higher productivity and hence less vulnerability. Similarly, less dependence on environmentally harmful resource use would eventually decrease vulnerability to both disasters and price volatility and hence improve resilience. Improved access to efficient and renewable sources of energy has the potential to reduce poverty and inequality while at the same time abate harm to the environment.

Asia-Pacific countries will need to address their macroeconomic, social and ecological imbalances in an integrated manner. Strategies will therefore need to take into account the economic, social and environmental imbalances simultaneously. They will need to consider the impacts of policy measures on the three imbalances, giving the highest priority to policies that address more than one imbalance at the same time.

The Economic and Social Survey of Asia and the Pacific 2013 comprises four chapters. Chapter 1 entails an examination on how the ongoing global economic crisis is affecting the resilience, inclusiveness and sustainability of the region’s development process and to what extent its impacts are exacerbated by structural impediments caused by past policy inadequacies, such as declines in public investment in agriculture, a concern raised in the ESCAP 2008 Survey, Sustaining Growth and Sharing Prosperity.

The assessment finds that the prolonged global economic crisis, in particular the double dip recession in many European countries and uncertainty in the United States surrounding its fiscal policy, is testing the resilience of the Asia-Pacific economies. There has been a generalized slowdown in almost all countries in the region, including the two regional powerhouses, China and India. It is likely that this generalized slowdown is being compounded by the existence of structural impediments, such as rising inequality, falling investment in agriculture, low social protection and low fiscal revenues.

Therefore, in responding to the generalized slowdown, the countries need to simultaneously address their long-term impediments by careful design of stimulus policies, a message also contained in the ESCAP 2010 Survey, Sustaining Recovery and Dynamism for Inclusive Development. As the ESCAP 2012 Survey, Pursuing Shared Prosperity in an Era of Turbulence and High Commodity Prices noted, most countries are in a favourable position to undertake a wide range of measures to simultaneously stimulate and address structural bottlenecks to achieve inclusive, equitable and resilient sustainable development.

Chapter 2 contains an analysis of subregional impacts of the ongoing global developments in which structural impediments are identified at the subregional and country levels. The analysis indicates, for example, that progress in South and South-West Asia is being seriously hampered by power shortages; that structural problems in North and Central Asia are related to the subregion’s
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resource dependence and narrow economic base; and that geography and size continue to be serious obstacles for the Pacific island developing economies. In addition, over dependence on exports and a rapidly ageing population are posing a challenge for countries in East and North-East Asia and South-East Asia.

Following the identification of structural impediments in chapters 1 and 2, an argument is made in chapter 3 for the implementation of forward-looking macroeconomic policies with government playing a critical role in enhancing the resilience and inclusiveness of development in the region. The macroeconomic policy paradigm that has dominated since the early 1980s emphasizes stabilization in the narrow sense of keeping inflation at a very low single digit level and achieving a primary budget surplus or a very low deficit-to-GDP ratio. Many countries have achieved these stabilization targets at the cost of development, for example, by cutting public investment in key areas and expenditures on education and health. As shown in chapter 1, many of the current structural impediments were the result of this short-termist policy paradigm and its focus on nominal targets.

There is a need to bring back a balance between the stabilization and the developmental roles of macroeconomic policies

The dominant paradigm sees macroeconomic stability or achieving inflation and debt targets as being both necessary and sufficient for development outcomes. The experience of the 1997-1998 Asian financial crisis and the Great Recession have, however, proven this belief wrong (see box C). Macroeconomic stability since the late 1990s, what many have termed as the “great moderation” with its smoother business cycles, could not prevent the Great Recession. Worse, the pre-eminence of keeping variables, such as inflation and debt, within narrow nominal targets has made macroeconomic policies procyclical and exacerbated crises, as can be seen in the continuing economic meltdown in the euro zone and uncertain economic recovery in the United States.

Thus, there is a need to bring back a balance between the stabilization and the developmental roles of macroeconomic policies. This would entail changing the way fiscal and monetary policies are designed and implemented and how issues of public debt or inflation are viewed. In particular, there has to be greater emphasis on the quality and composition of public expenditure, rather than on aggregate budget deficits and public debts, an argument alluded to in the ESCAP 2009 Survey, Addressing Triple Threats to Development. Likewise, in the case of monetary policy, there has to be more careful scrutiny of the direction or disbursement of credit instead of aggregate credit growth. In sum, the aim of fiscal and monetary policies should be to enhance the inclusiveness, resilience and sustainability of development, which will also contribute to improving human security.

Policy attention must also be devoted to elements of the social and environmental pillars

As the experience of the financial crisis has shown, it is possible to design fiscal stimulus packages and formulate monetary policies to increase public expenditure on critical infrastructure, health, education and social protection, and to extend more credit to productive and employment-intensive sectors, such as agriculture and small and medium sized enterprises (SMEs) (see box D). Carefully designed fiscal and monetary policies to support production and employment creation can support economic activity without causing inflationary pressures. Notably, countries that have retreated from developmental macroeconomics have jeopardized economic recovery at a great human and social cost. For example, Malaysia, the Republic of Korea and Thailand responded to the Asian financial crisis of 1997-1998 with well-targeted expansionary fiscal and monetary policies, which helped them recover quickly. On the other hand, Indonesia took longer to recover as it lingered in a vicious cycle of low
Box C. Asian financial crisis despite macroeconomic stability

Macroeconomic stability in the conventional sense of single-digit inflation and low or no budget deficit did not protect countries in East and South-East Asia from external shocks, which resulted in a major financial crisis in 1997-1998. For instance, both the Republic of Korea and Thailand experienced the shock despite more stable inflation and lower debt burdens relative to GDP. Having a balanced or surplus budget also proved inadequate (see figure B).

Figure B. “Sound” macroeconomic indicators before the crisis


growth and high public debt as the Government implemented procyclical macroeconomic policies to contain debt and keep inflation low. In sum, rethinking of macroeconomics in the region is needed in order to simultaneously tackle the short-term effective demand problem and long-term structural impediments to resilient and inclusive sustainable development.

The final chapter of the Survey 2013 contains estimates of required public investment for a set of policies to enhance the region’s resilience and inclusiveness. These policies include the provision of an employment guarantee for a limited number of days in a year, basic social services in education and health, income security to older persons and persons with disabilities and ensuring efficient energy for all by 2030. The choice of these elements was determined partly by the structural impediments identified in chapters 2 and 3. They were also derived from the commitments made by the countries at various United Nations conferences and summits, leading to global campaigns, such as “health for all”, “education for all”, “education first”, “social protection floor” and “sustainable energy for all”.

8
A number of countries responded to the 2008-2009 economic crisis with significant stimulus packages. Many of these included spending on the construction and maintenance of public and social housing. For example, China announced that it would spend 400 billion yuan ($64 billion), 10% of its total stimulus package on public housing. The stimulus package of Viet Nam included 24 trillion dong ($1.41 billion), equivalent to 17% of the total allocated for stimulus measures, to build houses for workers and low-income families. China, Indonesia, Japan and Thailand also announced direct or indirect health funding, such as increased spending on public health. Some countries included new measures for education. For example, China spent 150 billion yuan on primary education, including pro-poor and pro-rural health care and education; Malaysia committed 200 million ringgit ($64.3 million) to preschool education.

The crisis has also prompted Governments to accelerate plans to expand social protection coverage. For instance, China launched a major reform in December 2009 to introduce a basic pension scheme for 700 million rural inhabitants (ILO, 2010c). Pakistan introduced the Benazir Income Support Programme for 6-7 million poor households. The Philippines launched a conditional cash transfer programme which is being rapidly scaled up in response to the crisis.

In the Asia-Pacific region, several countries provided unemployed and laid-off employees with job-training programmes. For example, Thailand targeted new graduates, while Bangladesh focused on laid-off returning migrant workers. Viet Nam offered loans at preferential rates to the poorest members of the population to encourage production and trade in rural areas. Public works programmes, sometimes referred to as cash-for-work programmes or employment guarantee schemes, were adopted in many countries in response to rising unemployment.


Notes: These total amounts may underestimate the actual size of the social protection components of the fiscal stimulus measures in some countries. This may be the result of differences in definition and the classification of additional social expenditures under different categories. Social protection measures are defined here as policy interventions to reduce poverty and vulnerability and to improve human welfare. Examples of such interventions include public education, health and housing, labour market and social protection measures, as well as contributory social insurance programmes and non-contributory safety net (social assistance) programmes.
By highlighting these specific elements, attention is drawn in chapter 4 to the fact that rather than focusing exclusively on the economic pillar, policy attention must also be devoted to elements of the social and environmental pillars. Ensuring that public services are made available to all is a critical element in making development more inclusive. Additionally, strengthening the social and environmental pillars also fortifies the economic pillar, thereby making development more sustainable. For instance, investments in health, education and social protection will strengthen the economic pillar by increasing productivity through a healthier and more educated labour force and by reducing the precautionary motive for saving and thus increasing the amount of capital available for investment. As another example, broadening access to energy through investments in renewable energy and in technologies to improve energy efficiency contribute to reducing the impact of economic growth on energy prices and carbon emissions. These investments could also offer opportunities for technological innovations, business development and employment in promising “new economy” industries, thereby fostering development.

The exercise in chapter 4 shows that the required public investment for the set of policies to enhance resilience and inclusiveness would range between 5 and 8% of GDP for most of the countries analysed. Within these estimates, the contribution of individual policies varies, reflecting different demographic and economic characteristics. For example, the required expenditure for providing a job guarantee for a limited number (100) of days at the wage rate equivalent to respective national poverty lines ranges between 1% of GDP in China and the Russian Federation and 8% of GDP in Bangladesh. Similarly, ensuring income security to older persons would require between 1 and 4% of GDP for most countries. Such investment requirements (1) are within the affordable range for most Governments, (2) will remain fiscally sustainable and (3) will not destabilize the macroeconomy even with debt financing due to the reinforcing impact that greater investment and expenditure on inclusive development has on sustainable growth. In the chapter, it is argued that the region will benefit from stronger productivity growth underpinned by stronger social and environmental pillars.

These results are very encouraging for fulfilling Governments’ commitment to full employment, enshrined in the United Nations Charter (article 55), as well as their commitments to internationally agreed development goals derived from United Nations conferences and summits since the early 1990s. Therefore, forward-looking macroeconomic policies are needed not only to enhance the resilience of the people and inclusiveness of sustainable development but also to enhance human security and deliver on the right to development. Finally, the public policies discussed in this Survey can strengthen the social glue that binds communities and enhances citizenship.

Endnotes

1 See General Assembly resolution 55/2 of 12 February 2010.


3 See General Assembly resolution 65/1 of 22 September 2010.

4 See for example Fei, Ranis and Kuo (1979), Adelman and Robinson (1978) and Campos and Root (1996).

5 See General Assembly resolution 65/1 of 19 October 2010.


WHY FORWARD-LOOKING MACROECONOMIC POLICIES FOR INCLUSIVE AND SUSTAINABLE DEVELOPMENT IN ASIA AND THE PACIFIC?

INTRODUCTION
We countries in Asia should strive to balance economic growth, social development and environmental protection.  

Xi Jinping,  
President of the People’s Republic of China

Development in Asia and the Pacific is under pressure with the region increasingly buffeted by the travails of the developed world. Growth in the developed world has continued to slow as the euro zone fell into a double-dip growth contraction and growth in the United States remained in anaemic territory. The generalized slowdown across the region in 2012 points to structural issues, such as rising inequality, and energy and infrastructure shortages, due to past policy mistakes and inadequate policy responses. The solution to invigorating the domestic drivers of growth in the region lies in making the development process more inclusive and sustainable.
As a result of reduced demand in the developed world, the Asia-Pacific region experienced a broad-based slowdown in 2012. The persistent climate of economic policy uncertainty in the euro zone and the United States is estimated by ESCAP to have reduced GDP in the Asia-Pacific region by 3% below what it would have been otherwise, with a total loss in GDP of $870 billion. A number of large economies in Asia and the Pacific, most notably those of China and India, which proved resilient in the early part of the Great Recession of 2008-2009, subsequently have slowed markedly, reducing the support they had previously provided to Asia-Pacific economies through the channel of intraregional demand.

ESCAP analysis indicates that lower growth compared to recent years could become a “new normal” for many regional economies if present economic trends were to continue. The output loss could be significant for the region as a whole at almost $1.3 trillion from the start of the crisis until 2017. Policies to create or strengthen alternative sources of growth should be viewed as a priority in order to prevent the onset of the “new normal” of lower growth.

The impact of the generalized slowdown on inclusive and sustainable development in the region stands to be substantial. The slowdown in 2012 of the two powerhouses of the region, China and India, has been the key new concern for the smaller economies of Asia and the Pacific. The slower growth in the major regional economies has reduced demand for imports from the smaller exporting economies in the region. However, a more positive development in the medium-term is likely to arise from the ongoing effort to rebalance the Chinese economy towards being more consumption-led, in line with the government’s efforts to reduce hardcore poverty, income inequality and regional disparities. This rebalancing may produce a net positive impact on other countries in the region by creating new sources of demand in the Chinese economy. ESCAP analysis indicates that the total benefit in exports for the region would be nearly $13 billion during the period 2013-2015.

Economies in the region confronted by the challenges of slowing demand in the developed world will have to consider implementing supportive measures at the domestic and regional levels to maintain their development progress. In addition, governments will have to take action to ensure specifically that the jobs and incomes of the poorest and most vulnerable sections of society are protected during this difficult period.

The generalized slowdown across the region has been compounded by long-term structural issues, such as rising inequality and energy and infrastructure shortages, which can be partly attributed to past policy neglects and inadequate policy responses. In other words, the underlying causes of the difficulties being faced go beyond the impacts emanating from the developed world. The slowdown, which is affecting even economies of the region that have large domestic markets, highlights the shortcomings in the development strategies pursued over the past few decades.
The structural solution to invigorating the domestic drivers of growth for the economies in the region lies in making the development process more inclusive and sustainable. Countries are increasingly giving prominence to social protection measures. In this regard, the introduction of minimum wage requirements is another policy gaining increased resonance in the region. ESCAP analysis indicates that a minimum wage policy, if designed carefully along with supportive adjustment measures, boosts workers’ income and improves long-term job prospects without adversely affecting businesses. For example, recent minimum wage hikes in Thailand are projected to increase employment growth by up to 0.6 of a percentage point by 2015, while real GDP growth is expected to increase by 0.7 of a percentage point above the level foreseen if no minimum wage increases were implemented.

Many economies in the region are well-placed to undertake well-targeted fiscal and monetary policies directed to productive and social sectors of the economy.

Fortunately, many economies in the region are well-placed to undertake the measures required through the use of well-targeted fiscal and monetary policies directed to productive and social sectors of the economy with high-employment intensity. In addition to contributing to sustained economic growth, such coordinated and well-designed policies can also support efforts to mitigate climate change while advancing developmental aspirations and ensuring affordable food security.

There is also a high degree of complementarity among the regional economies in terms of natural and human resources. Additionally, the region as a whole has a large volume of financial reserves. Thus, enhanced regional cooperation offers an avenue for escaping from adverse external developments as well as for addressing long-term development deficits. Countries must avoid a race to the bottom by competing among themselves with tax concessions or lowering environmental and labour rights protection to lure foreign investment. Ultimately, no one wins from these kind of beggar-thy-neighbour policies; instead, these policies are harmful for all.

HEIGHTENED VULNERABILITIES AND POLICY CHALLENGES

Uncertain global environment requires vigilance

The key concern for the global economy remains the spillovers from the difficulties in the euro zone, with the euro zone slipping back into a double-dip recession in 2012 (see figure 1.1). Despite a raft of policy measures over the past year supported by the European Union and the International Monetary Fund (IMF) to enhance the confidence of the financial markets, instability continues, as evidenced by periodic increases in spreads at debt auctions to unsustainable levels.1

Underlying the response of the financial markets is a fundamental uncertainty about the use of austerity as the primary response to reduce debt ratios. One concern is whether the level and duration of austerity being attempted will be politically and socially feasible. In recent months, there have been widespread protests by the populace in austerity-ridden economies with such upheavals only likely to grow as spending cuts and job losses continue. The jobless rate in Spain in the last three months of 2012 rose to 26%, or 5.97 million people, the highest level since the mid-1970s, due to the country’s prolonged recession and deep spending cuts. Youth unemployment surged to 55%. The unemployment rate in Greece also increased in the final quarter of 2012 to more than 26.8%, the highest level in the European Union, with youth unemployment edging towards 60%. Portugal registered the third highest unemployment level in the European Union at 16.7% by the third quarter of 2012, a record for that economy.

More fundamentally, it remains highly unlikely that the current austerity policies will achieve the purpose of bringing down debt to GDP ratios to proposed
levels. This is because austerity is leading to sharper contractions in economic growth than expected by those designing such policies, causing both a slowdown in the reduction of debt as government revenues decrease, as well as leading to increases in the required reduction of debt to meet debt-to-GDP ratio targets given that GDP itself is contracting. In fact, the IMF has recently noted that there was a serious miscalculation of the depth of the resulting negative impact of austerity policies on growth when it first recommended fiscal consolidation during the early phase of recovery (IMF, 2012c).

If the contractionary impact of austerity measures continues, eventually the countries in debt crisis will default or will have to unilaterally change their terms of debt repayment. In that case, these countries may not continue to be accepted as members of the euro zone. If such a worst-case scenario of a disorderly debt default or countries exiting the euro zone were to play out, the impact on the global economy as well as on Asia and the Pacific may be severe. The first consequence of such an unexpected event would be significant instability in the financial markets as systemically important banks would be affected by an unexpected “credit event”. Furthermore, confidence in the euro, a major world currency used as a store of value and medium of exchange, would be affected. Most immediately, the region may see an exit of capital in a “flight to safety” as occurred in 2008 following the collapse in the subprime market and the demise of Lehman Brothers. In the real sector, if such a “credit event” is accompanied by a country exiting the euro zone, the consequence could be a sharp contraction in growth for the affected country as economic activity would be constrained during the complications arising from a change of currency and non-repayment of debt. In addition to these impacts, the contagion impact in terms of perceptions of other countries engaging in such an exercise in the future would lead to further decreases in economic activity in the euro zone. The resulting contraction of economic activity in the euro zone could have a substantial adverse impact on Asia and the Pacific through the trade and finance channels.

The situation in the United States seems slightly better in comparison to the travails of the euro zone and has provided some support to the global economy. The economy has experienced volatile but positive growth in recent quarters (see figure 1.1), although the initial estimate of fourth quarter GDP growth was in slightly negative territory due to uncertainty tied to the outcome of the “fiscal cliff” negotiations. There

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Figure 1.1. Real quarterly GDP growth of major developed economies, year-on-year, 2007-2012

are signs that the housing market, a key driver of the recession in the economy, may have bottomed out as evidenced by a range of noisy but broadly positive data readings over recent months. Consumer confidence also appears to be recovering, a key requirement given the consumption-dependent nature of the economy. Unemployment, as a consequence of this steady increase in economic activity, has been on a downward trend. Given the importance of the United States as an export market globally, and specifically for Asia and the Pacific, the positive growth in the United States economy may provide some support to growth in the region. Nevertheless, growth rates and demand in the United States remain far below their levels before the crisis and therefore do not assist growth in the region to the same degree as they did prior to 2008.

The negotiations on resolving the fiscal programme of the United States in coming years, through numerous interrelated legislative deadlines such as the “fiscal cliff”, the budget sequester, the continuation of government funding and the raising of the debt ceiling, have created additional difficulties for Asia-Pacific economies. The problems stem from not only the actual impacts of these decisions on spending and growth in the United States but also from the uncertainty created by a series of partial measures to deal with the issues which have served to delay final resolution. The lack of clarity regarding the economy’s medium-term fiscal policy position is tied to legislative deadlock, resulting in a series of short-term pacts and extended uncertainty on global financial markets in response to concerns about the health of the United States economy. This uncertainty has affected the region through periodic episodes of short-term capital outflows from Asia-Pacific markets. Any possible composition of the eventual outcome of the negotiations to resolve the fiscal programme of the United States will result in a reduction in demand in the United States as taxes are increased and government spending is curtailed. Given that spending cuts may be undertaken along a ten-year horizon, some measures could be backloaded to occur once the economic recovery is more solid. Nevertheless, it is likely that growth in the United States will be put under further pressure by reduced demand that will result from the pact. It can be argued that the United States is currently engaged in a moderate form of austerity, a reversal from its previous expansionary policy stance.

The persistent climate of economic policy uncertainty in both the euro zone and the United States has markedly affected regional output levels

The persistent climate of economic policy uncertainty in both the euro zone and the United States is estimated by ESCAP to have reduced GDP in the Asia-Pacific region by 3% below what it would have been otherwise. This equates to total loss in GDP of $870 billion. However, the analysis shows that governments in the region could fortify their economies against the impact of such economic uncertainty by implementing pro-active policies. This could on average, moderate the negative effects on GDP for countries by around 75%. With regard to employment, pro-active policies could save large number of jobs, up to 2.6 million workers just in the case of China (see box 1.1).

The outlook for the economy of Japan remains subdued. Given the importance of exports for the Japanese economy, the global slowdown has substantially affected its growth prospects. While the economy initially benefited from an uptick in growth in 2012 due to the resumption of economic activity following the Great East Japan Earthquake, growth has now retreated towards the moderate levels seen over past years (see figure 1.1). Exports had particularly suffered as the yen appreciated strongly up until the third quarter of 2012 due to the repatriation of funds by the domestic financial sector. The enactment of a large new round of fiscal stimulus in early 2013 of $116 billion combined with a policy of monetary easing with an inflation target of 2% and a depreciation in the exchange rate offers the possibility of some additional increment to domestic demand and exports in coming months. However, the impact of the country’s current slowdown on Asia and the Pacific is limited as the
Box 1.1. How has policy uncertainty in the euro zone and United States affected Asia and the Pacific?

In the past few years, the world economy has been characterized not only by lower growth but also by increased economic uncertainty. Near-term economic prospects have become more unpredictable, with sharp upward and downward revisions in growth projections. Policy uncertainty in developed economies is the main factor behind this environment. Examples of issues that are triggering this unclear environment include divided negotiations on the fiscal cliff and debt ceiling in the United States, a possible breakup in the euro zone, and the timing and size of monetary injections by various monetary authorities.

Uncertainty in advanced economies threatens global economic stability. Consumers delay their spending on durable goods and housing due to heightened job insecurity. Businesses are reluctant to expand operations given less predictable demand. Financial institutions also tighten lending standards as perceived default risks escalate. In addition, massive inflows and sudden reversals of foreign capital, particularly in the form of short-term portfolio investments, add volatility to domestic financial markets. The stalled growth in the United States in late 2012, underpinned by widespread concerns over the outcome of the fiscal cliff negotiations, emphasized the significance of economic uncertainty.

Economic uncertainty appears to have risen in Asia and the Pacific in recent years. The volatility of daily stock market indices, a high-frequency variable that is very sensitive to changes in market sentiments, surged in 2008-2009 relative to the pre-crisis period (see figure A). This finding also remains generally true when measured over the longer period of 2008-2012, a period in which episodes of macroeconomic upswings and downswings occurred. Similarly in the real sectors, export-oriented economies, such as Malaysia, Republic of Korea, Thailand and Hong Kong, China registered more pronounced changes in inventories as a share of GDP during the crisis years of 2008-2009. Rapid destocking and restocking of inventories often indicate large mismatches between anticipated and actual shipment orders. Overall, fluctuations in the trade and domestic components of GDP have pushed up volatility in output growth in most regional economies (see figure B).

Based on a counterfactual analysis, ESCAP finds that if advanced economies were exposed to lower policy uncertainty between 2008 and 2012 than actually observed, the annual output levels of Asia-Pacific economies would have been 3% higher on average (see panel A in figure C). Here, it is assumed that a less volatile macroeconomic environment benefits growth performance through...
at least two channels: stronger market confidence and lower bond market distress. In the Philippines, Turkey, and Hong Kong, China, the estimated impact in any given year during the period 2008-2012 could be up to 7.9% of total output. These estimates are sizeable, considering that the assumed magnitude of improvement in market confidence and bond market distress is relatively modest. Meanwhile, the analysis also shows that the impact is slightly more modest if increased economic certainty helps to support market confidence, but does not reduce perceived risks in the financial sector (represented by unfilled markers in panel A).

ESCAP analysis, however, indicates that proactive fiscal and supportive financial policies could on average offset 75% of the impacts of policy uncertainty stemming from the developed world. The proactive government policies include: automatic stabilizers that sustain household consumption amid shocks, such as unemployment benefits for workers and agricultural price support and insurance for small farms; active macroeconomic policies to restore confidence, such as targeted cash transfers and bank deposit insurances; building and maintaining ample fiscal space; and structural and medium-term policies, such as a shift towards countercyclical fiscal policies and deepening domestic financial markets.

The second scenario assumes country-level policy responses which result in stronger market optimism and lower financial risks for the particular Asia-Pacific economies that implement such policies. Panel B in figure C shows the positive impact on GDP for each country through the application of proactive fiscal and financial policies. The magnitude of the output loss arising from policy uncertainty in the advanced economies can be moderated by an average of 75%. This reduction in the adverse impact of policy uncertainty can offer significant relief to citizens in terms of preserving jobs. In China, for example, proactive
Box 1.1. (continued)

policies could reduce the impact on unemployment by around 2.6 million workers in a single year. This employment effect in the Russian Federation could be as high as 800,000 workers.

a Destocking subtracted nearly 1.6 percentage points from United States output growth in the final quarter of 2012. This arguably was the result of firms making adjustments in preparation for weaker domestic demand if scheduled tax rate increases and spending cuts were to materialize.

b Here, volatility is measured by the coefficient of variation, i.e. standard deviation divided by its mean.

c More specifically, the scenario assumes that (i) consumer and business confidence in all economies in the model simultaneously fell by only two-thirds of the actual declines, and (ii) the gap between the interest rates on government and corporate bonds and a safe-haven interest rate was 200 basis points narrower than the actual margins. In the model, changes in market sentiments directly affect consumption expenditures, fixed investment and the stock market index. Given these assumptions and specifications, the size of the country-level impact depends, among others, on the contribution to GDP by domestic demand components as well as the linkages between the real sector and the stock and bond markets.

d According to the ILO, the proportion of unemployed persons who benefit from unemployment assistance in Asia is less than 20%. This compares to around 40% in Latin America and the Caribbean and as high as 80% in developed countries.

e See chapter 3 for more details on how to strengthen countries’ economic resilience.

f The second scenario assumes improvements in market confidence and bond market distress of similar magnitudes as the first scenario. The difference is that here the changes are applied to each Asia-Pacific economy individually rather than to all economies in the model simultaneously as in the first scenario.

Weak economic environment heightens labour market vulnerabilities

The weak global economic climate continues to put downward pressure on Asia-Pacific labour markets in terms of employment creation and the quality of jobs. In a sample of 13 economies with year-end 2012 employment data, 10 economies witnessed a year-on-year job growth decrease compared with 2011. Notably, employment growth in Indonesia decelerated by 333,000 jobs in August 2012 as compared with August 2011. The Philippines saw a sizeable contraction in employment of 882,000 jobs from October 2011 to October 2012. Job growth also moderated in the more industrialized economies of Japan, the Republic of Korea, Singapore, New Zealand, Hong Kong, China and Taiwan Province of China.

Although overall unemployment remained typically low in most Asia-Pacific economies (often below 5%), young people continue to face considerable disadvantages in terms of securing decent employment (see figure 1.2). Despite some recent progress, more than one in six young people in the labour force remain unemployed in Indonesia, Sri Lanka, the Philippines, New Zealand and Hong Kong, China. Across the region, economically active youth on average are three to five times more likely to be unemployed than their adult counterparts. Among the Pacific island countries, young people in Samoa and Vanuatu make up almost 60% and 50% of the total unemployed population, respectively. In the Marshall Islands the youth unemployment rate is almost three times the adult unemployment rate. In terms of gender differences, unemployment is more prevalent among young women than young men in the South-East Asia and the Pacific and South Asia subregions; this trend is reversed in the East Asia subregion where the youth unemployment rate for males is higher than for females (ILO, 2011c). Given the uncertain global economic environment, youth unemployment is forecast to edge slightly upwards in 2013, to 13.4% in South-East Asia and the Pacific, 10% in South Asia and 9.8% in East Asia (ILO, 2013).

Unemployment, however, is only one dimension of the jobs predicament facing youth as the number of young people working in poor quality and low-paid jobs is much greater than the number of unemployed young people. In developing Asia, poverty rates
are commonly higher among working youth than working adults (ILO, 2011c). Moreover, the youth employment challenge highlights another important feature in particular for some of the region’s emerging and industrialized economies. This is the increasing importance of absorbing young jobseekers into the labour market as populations age, labour forces shrink and new drivers of growth are needed. To this end, policymakers should focus on employment-centred macroeconomic policies that foster stronger aggregate demand and job creation as well as improved access to finance and credit. Other key measures to consider are developing education and training systems to ensure skills are more relevant, investing in active labour market policies, fostering youth entrepreneurship and ensuring rights for young people (ILO, 2012i).

In addition, the prolonged global economic recession is hampering prospects for improving working conditions and raising the quality of employment throughout Asia and the Pacific. Nearly three in five (or nearly 1.1 billion) of the region’s workforce remain trapped in low quality, vulnerable jobs as own-account or contributing family workers (ILO, 2013). Vulnerable employment rates are notably higher in the South Asia subregion at 76.9%, accounting for 491 million workers. Moreover, vulnerable employment is more pervasive among women than men, underlining the comparative disadvantages that women in Asia and the Pacific face in accessing more secure and better jobs as wage earners.

Vulnerable jobs typically entail working in informal conditions with limited legal protection and access to basic rights at work. In this regard, job-related informality is pervasive throughout developing Asia-Pacific economies (see figure 1.3). Outside the agricultural sector in India, Nepal and Pakistan, around 80% of all workers are engaged in informal employment. In Indonesia, the Philippines and Viet Nam, the comparable shares are approximately 70%. Vulnerable and informal workers face tremendous difficulties in their ability to cope with external shocks (whether economic, social or environmental), given their low earnings and the precarious and irregular nature of their job arrangements. In turn, widespread informality and poor job quality pose significant concerns for policymakers seeking to reverse recent regional trends in high and rising inequality and rebalance their economies towards stronger domestic markets.

Addressing the crisis of poor quality jobs pervasive in Asia and the Pacific requires a multi-pronged approach which must include boosting labour
productivity. The global recession of 2008-2009 has moderated productivity increases considerably in comparison to the pre-crisis trend in a majority of Asia-Pacific economies (see figure 1.4). For example, in Cambodia, annual average productivity growth slowed by a striking 6.5 percentage points from 9.2% during 2002-2007 to 2.7% during 2008-2011. During the same periods, substantial deceleration also took place in the Islamic Republic of Iran (3.2 percentage points), China and Myanmar (2.7 percentage points), Malaysia (2.5 percentage points) and Pakistan (2.2 percentage points). This slowdown is even more worrying given that labour productivity levels in developed economies globally continue to outpace developing Asia-Pacific economies by a wide margin – ranging from five times the level in

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East Asia to seven times the level in South-East Asia and the Pacific and nine times the level in South Asia. Stronger policy emphasis on skills and human resources development, greater investments that boost productivity in the rural and small and medium-sized enterprises (SMEs) sectors and facilitating greater movement of workers into industry and services, among other measures, would be instrumental.

In addition to improving job quality, there is growing recognition throughout the region that fostering inclusive and balanced growth requires stronger labour market institutions. This includes wage systems that can help ensure that wages grow consistently with productivity increases. Higher wages and household incomes would facilitate the growth of domestic markets and reduce the region’s reliance on low-wage manufacturing exports to drive growth. To this end, minimum wage policies and related wage reforms have taken greater prominence, including, among other economies, Hong Kong China, Malaysia, the Philippines and Viet Nam (ILO, 2012a).

ESCAP analysis indicates that a minimum wage policy boosts workers’ income and improves long-term job prospects without adversely affecting businesses provided it is carefully designed along with supportive adjustment measures. For example, it is estimated that recent minimum wage hikes in Thailand would increase employment growth by up to 0.6 of a percentage point by 2015, while real GDP growth would also increase by 0.7 of a percentage point above the level without the minimum wage increase (see box 1.2).

**Food and fuel price pressures despite slowing headline inflation**

Headline inflation is down across many economies in the region as demand-side pressures decline in tandem with slowing economic growth (see figure 1.5). Price increases have also moderated in response to monetary policies which were progressively tightened across the region until early 2012 (see figure 1.6) when the balance of concerns between economic growth and rising prices was tilted more towards the latter at a time of relatively robust growth. Since early 2012, however, the reverse increasingly became the case and some governments, such as India, the Philippines, the Republic of Korea and Thailand have loosened monetary policies as one of their policy measures to support domestic economic activity to counteract the repercussions from slowing external sectors.

While headline inflation is down across the region, there remains considerable divergence in its level across countries. For countries with relatively high inflation, rising prices are often not due to increased demand or overheating but to supply shocks or rising production costs because of shortages of critical infrastructure. In some cases, rising prices are due to upward adjustment of administered prices or the removal of subsidies. One of the key shortfalls currently for many such economies is the enormous infrastructure gaps that exist between the requirements and actual investment. The availability of energy is the most immediate need for supporting economic activity.

An additional complication in the management of price pressures is the high and volatile prices of food and fuel across many economies in the region. It can be seen that movements in consumer price inflation in many economies of the region substantially track movements of global food and fuel prices (see figure 1.5). Global oil prices since the nadir of the global recession in 2009 have increased dramatically in a volatile manner. Driven by geopolitical instability-related supply concerns in the Middle East, prices remain at over $100 a barrel for Brent crude. Of even greater concern is the evolution of food prices in recent months, with the FAO food price index of key commodities increasing to near record levels on the back of weather-related shortages in key producer economies.
Box 1.2. Recent minimum wage policies boosting inclusive growth

Wage growth in Asia and the Pacific has generally remained weak over the past five years despite relatively robust economic performance (ILO, 2012f). Likewise, minimum wages have fallen into neglect in some countries and they are often insufficient to meet workers’ basic daily necessities, including health care. With adjustments in minimum wages lagging behind rising GDP per capita, economic growth has not translated into higher wages, especially in relatively richer countries in South-East Asia and South and South-West Asia (see figure A). Apart from these general observations, the level of minimum wage rates can be seen to vary considerably across countries, driven by differences in domestic economic environments and prevailing labour market institutions. Many countries in the region, including Bangladesh, Bhutan, India, Kyrgyzstan, Myanmar, Sri Lanka, Tajikistan and Uzbekistan, have minimum wage rates set well below $100 per month (see figure B).

Recently, governments in the region have used minimum wages as a policy tool to protect vulnerable workers and to stimulate domestic demand. The implementation of minimum wages is also increasingly considered as an important component of industrial policy for promoting industrial restructuring towards higher value-added activities and diversification to maintain international competitiveness. Since the beginning of 2012, minimum wages have been raised or have been introduced for the
first time in more than 20 economies across the region. Malaysia was the most recent economy to establish a comprehensive national minimum wage in January 2013, set at 900 Malaysian ringgit (RM) ($290) a month for Peninsular Malaysia and RM800 for Sabah and Sarawak. Likewise, the new daily minimum wage of 300 Thai baht (THB) ($10) per day set in Thailand came into effect across the country in January 2013. This large increase of 40% or more, depending on the province, came after more than a decade during which minimum wages hardly kept up with inflation, and fell far short of productivity growth.

A common criticism of minimum wage adjustments is that they raise labour costs, resulting in layoffs of workers – especially SMEs. This may be a valid consideration if minimum wages were increased abruptly without appropriate measures for adjustment in labour-intensive sectors. However, fears that minimum wages \textit{per se} lead to employment losses appear to lack empirical verification. Instead, a recent World Bank study on Indonesia found that minimum wage increases succeeded in boosting wages in the manufacturing sector, but had not led to employment losses for manufacturing workers and had only had a minuscule impact on non-manufacturing workers.\footnote{This is in line with findings from developed economies that all point at the negligible negative employment effects of minimum wages.}

Moreover, minimum wages have many benefits apart from boosting workers’ income. Increased incomes for workers boost consumption demand, while increased labour costs trigger new economic activities with higher value-added content. Minimum wages thus improve the competitiveness of an economy by raising skill levels in preparation for increased international labour competition. Such wage policies also contribute to reduction of income inequality by redistributing income towards low wage workers. This, in turn, improves workers’ morale and reduces the risk of industrial unrest, which ultimately increases productivity and reduces worker turnover.

The multi-year simulation exercise of ESCAP, based on the actual data for Thailand, models the impact of minimum wage increases on employment and real GDP growth for the period 2012-2017. In Thailand, the previous province-level minimum wages have been successively replaced by a single minimum wage of THB300 per day for the entire nation in 2012 and 2013 – corresponding to nominal increases of 40% or more, depending on the province. According to the Government official figures, the labour supply grew by 1.4% in 2012, 0.5% faster than growth of the working-age population. Arguably, higher wages attract more people to enter the labour force, especially drawing workers from the informal economy, and helping to overcome the labour shortage in the country. Assuming that 5 million workers were paid less than THB300 per day before the wage increase,\footnote{The scenario analysis indicates that employment growth would accelerate by up to 0.6 of percentage point by 2015, while real GDP growth would increase by 0.7 of percentage point above the level without the minimum wage increase (see figure C). More importantly, the initial adjustment costs, the reason for which minimum wage laws are often criticised, are likely to be insignificant. The net negative impacts on employment and GDP growth are estimated at just under 0.1 of percentage point in 2013, implying that an increase in labour costs resulting from minimum wage increases would be offset by, or, in most cases, dominated by positive employment impacts due to a boost in domestic consumer demand.} the scenario analysis indicates that employment growth would accelerate by up to 0.6 of percentage point by 2015, while real GDP growth would increase by 0.7 of percentage point above the level without the minimum wage increase (see figure C).
The results of this macroeconomic simulation illustrate that recent minimum wage hikes in Thailand are unlikely to trigger significant unemployment. In fact, unemployment has fallen marginally in Thailand since the new minimum wage was first introduced in six provinces in April 2012, ahead of nation-wide implementation in 2013. Additionally, any price effect of the new minimum wage is likely to be short-lived and relatively small in size. It should be understood that minimum wage policies need to be designed to minimize any potential adverse impact. For instance, in China, minimum wage laws are regularly reviewed and revised at least once every two years to ensure that changes are not too drastic and do not have a significant short-term impact on overall economic growth. In Thailand, upon the announcement of the minimum wage hike in 2012, the government introduced several policy support measures to smoothen the adjustment phase for businesses, such as providing tax allowances and reducing employers’ social security contributions.

A minimum wage policy, if carefully designed and implemented with supportive adjustment policies by governments, increases incomes for workers, boosts consumption demand and helps narrow the earning gap. Moreover, it forces firms to improve production efficiency and hence contributes to economy-wide productivity growth. While some fear that higher minimum wages could have some short-term negative impacts on employment, inflation or GDP growth, these impacts have been found to be negligible in most cases – and need to be weighed against the long-term economic benefits and their positive social impacts. Nevertheless, it is important for countries that have introduced minimum wage legislation to undertake active labour market programmes in tandem with business support measures, especially for SMEs, to tide over short-term adjustment difficulties.

a Real wages grew regionally, on annual average by 5.2% in the years 2008-2011 compared to the regional average annual GDP growth of 6.8% over the same period. If China is excluded from this calculation, real average wages contracted by 0.3% per annum.

b Minimum wage is defined by the International Labour Organization (ILO) as “the lowest level of remuneration permitted which in each country has the force of law and which is enforceable under threat of panel of other appropriate sanctions. Minimum wages fixed by collective agreements made binding by public authorities are included in this definition.” (ILO, 1992). Also, the number of minimum wage rates set within the same country is also quite different. Some countries have only one national minimum wage rate, whereas others have multiple minimum wage rates by districts, occupations, age, and qualification. India, for instance, has more than 1,200 different rates.

c See for details Del Carpio, Nguyen and Wang (2012).

d This assumption is in line with the number estimated by the National Economic and Social Development Board, a Thai government agency.

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Figure 1.5. Oil price, FAO food price index and consumer price inflation (year-on-year) in selected developing Asia-Pacific economies, 2007-February 2013


Note: LHS panel: y-axis refers to monthly values of FAO food price index and crude index; RHS panel: y-axis refers to the year-on-year monthly values of CPI of the selected economies.
Food and fuel price rises have been exaggerated by the increasing financialization of commodity markets

As highlighted in the ESCAP 2009 Economic and Social Survey of Asia and the Pacific (ESCAP, 2009a), food and fuel price rises due to concerns about supply-related shortages have been exaggerated by the increasing financialization of commodity markets. Commodity assets managed by financial investors have increased over the past decade from less than $10 billion to $404 billion in June 2012. Loose monetary policies of the developed world, most notably quantitative easing (QE) in the United States, along with the unwillingness of governments to regulate participants in commodity markets, have continued to draw excess funds to the commodities markets due to the markets’ comparatively high expected returns. The presence of financial investors, betting on an increase in fundamental prices due to supply shortages, serves to exaggerate price increases.

The commencement in 2012 of a new round of QE, referred to as QE3, is expected to contribute to the pressure as investors are driven into all global asset classes. In the long-term, with a perception that food and fuel prices are on an increasing trend due to growing global wealth and finite supply, such commodities present a compelling investment story. Furthermore, the participation of financial investors is driven by herd behaviour which suffers from periods of mass entry and withdrawal from such markets. The resulting volatility in food prices hurts commodity producers as the accuracy of medium-term decisions regarding production based on prices is jeopardized.

Without regulations that are aimed at managing the participation of financial investors, price rises will continue to be exaggerated. Implementation of legislation agreed under the Dodd-Frank Act in the United States to limit the holdings of financial investors in commodity markets which was set to begin in October 2012, continues to be delayed. As of December 2012, financial regulators have issued only 48% of final rules mandated by the Dodd-Frank Act of 2010, and have missed deadlines for implementing 89% of the Act’s provisions (Government Accountability Office, 2013).
The other element of policy-induced distortion to the commodity markets has been the growing impact of biofuel mandates. With mandates in place in the United States and the European Union on the amount of fuel to come from biofuels, substantial amounts of the developed world’s crop production is being redirected towards fuel. In the United States, high and progressively increasing mandates for the minimum amount of total fuel to come from biofuels are already in place. It is estimated that around 40% of corn production in the United States is now devoted to biofuel (Graziano da Silva, 2012), up from negligible levels in 2000. With drought affecting corn production combined with no relaxation in mandated biofuel levels, the proportion of corn being redirected is likely to increase even further in the short-term.

In the case of the European Union, the mandate for 10% of fuel to come from biofuels by 2020 has led to countries already self-imposing mandates at varying levels in an effort to meet the requirement by that date. Since the amount of food crops available to produce biofuels in the European Union is limited, the mandates have an immediate knock-on effect on food production in other regions, such as the developing world. Coupled with the existing impact of mandates, the high price of oil has increased concerns that governments will be under pressure to increase the role of mandates to reduce the growing impact of fossil fuel dependence on pump prices.

In a number of developing economies in the region, high food prices partly stem from domestic structural factors such as low productivity or lack of extension services due to cuts in public spending, which affect the supply of food crops. Government policies often attempt to ensure food security by insulating the domestic food market from global forces through export control measures. Nevertheless, global prices still have some effect on such economies through avenues such as the need for procurement prices to track global prices to some degree to discourage smuggling abroad of food crops.

Tight monetary policy is not the appropriate primary response to inflation due to supply bottlenecks, administrative price adjustments or food price rises, as it dampens general domestic economic activity without addressing the structural factors underlying the price rises. The more appropriate response to dealing with economies with such supply constraints is to create a supportive environment for investment through accommodative interest rate policies in general, supplemented by directed credit to areas of critical need, including agriculture and rural infrastructure. Public procurement and distribution of food can also play a significant role in addressing food price inflation.

**Macroeconomic instability heightening through short term capital inflows**

Macroeconomic stability of economies in the region is being imperiled by the fresh wave of global short-term capital coming to its shores spurred by expansionary monetary policies in the developed economies. In September 2012, the United States Federal Reserve announced the resumption of an aggressive asset purchasing programme to the value of $40 billion per month in mortgage-backed securities, with the intention of lowering long-term interest rates, spurring economic activity and creating jobs. This original value was further boosted in December 2012, adding an additional $45 billion a month in purchases of Treasury bills. Unlike previous quantitative easing measures, this new programme of $85 billion in monthly asset purchases is open-ended and set to continue until there is a significant improvement in labour market conditions. The European Central Bank, the Bank of Japan and many other advanced economies’ central banks have also undertaken variants of QE and other forms of unconventional monetary policy. Furthermore, in early 2013, Japan outlined plans to start a monthly purchase plan of $145 billion in assets from the start of 2014 to boost growth and combat deflation.
Expansionary monetary policies in the developed world are once again leading to difficulties for macroeconomic management in the region. This is due to the logical decisions of financial investors to reallocate their funds from the depressed bond markets in the developed world to currency and asset markets in the region. Current and probable medium-term investment returns in this region are far more attractive in terms of both interest rate differentials and medium-term economic growth prospects. The comparative attraction of this region remains largely unchanged since the previous two rounds of QE earlier in the Great Recession of 2008-2009. The impact on capital flows to Asia-Pacific economies during the two earlier rounds of QE was severe, and there is little reason to suspect that the outcome will be any different this time around.

The announcements and implementation of the renewed QE measures in advanced economies had immediate spillover effects on asset markets in the region (see figure 1.7). From the onset of QE3, the Philippines saw net capital inflows, mainly in the form of portfolio investment, nearly triple in September and October 2012 from the same period a year earlier. Indonesia and the Republic of Korea also experienced a net inflow of about $1.3 billion and $1.4 billion, respectively, in September 2012, compared with a net outflow of $540 million and $2.4 billion the month before. Net foreign investment in bonds of the Republic of Korea rose to a 17-month high in December 2012, largely due to an optimistic economic outlook and speculation that the Korean won would continue to appreciate.

Equity markets in the region rallied, with the MSCI index gaining 2.36% one month after the announcement of QE3 in September 2012, and up to 9.18% three months after the announcement (see figure 1.8). The greatest rises were seen in the equity markets of the Republic of Korea and Hong Kong, China. The property sector is another area of interest for financial investors. For example, during the first month following the announcement of QE3, house prices in Hong Kong, China rose by 3%, while in the Republic of Korea and Singapore, they gained 1.195% and 1.125%, respectively. Governments have responded with a host of cooling measures in the property sectors. For example, in October 2012 and January 2013, the Monetary Authority of Singapore introduced a number of measures to contain a risk of property price bubbles. In October 2012, the government of Hong Kong, China raised the stamp duty on house purchases to stave off speculative investment flowing into the property markets.

Figure 1.7. Asset responses after quantitative easing implementation announcements, percentage change

In the foreign exchange markets, on the back of massive capital inflows in September 2012, the Chinese yuan was pushed to its highest level since the official and market exchange rates were unified at the end of 1993. The progressive strengthening of the yuan against the dollar continued into the latter part of 2012 (see figure 1.9). Some regional currencies also experienced rapid short-term appreciation; the Thai baht gained about 0.57% against the United States dollar a day after the announcement of QE3 relative to the day before, while other regional currencies appreciated at a slower but more steady pace, such as the Korean won which was up 1.81% against the United States dollar a month after the QE3 announcement compared to its level the day before the announcement. The Korean won appears to have experienced the most consistent gains, appreciating more than 6% against the dollar relative to its pre-QE3 value by mid-January 2013, with emerging concerns that this could hurt the price-competitiveness of local exporters.

It should be noted that exchange rate movements are not a wholly accurate reflection of the extent of appreciation pressure, as governments have engaged in substantial foreign reserve accumulation (see figure 1.10) over recent years in order to dampen currency rises. Countries are engaging in a competition to best manage their currency values relative to their competitors in order to protect the fortunes of their export industries, an attempt which is especially important at a time of reduced export demand. This exercise, however, is extremely costly as the resulting accumulation of foreign reserves imposes significant costs on governments. One is the direct cost of earning less interest income on the reserves compared to the interest cost of the accompanying domestic monetary sterilization, while the other is the opportunity cost of alternative uses of such funds for more productive investments. However, the increase in foreign exchange reserves witnessed in a number of countries, such as Bangladesh, is a more positive development as such economies are not as exposed to global financial flows, but instead have to maintain sufficient reserves to contend with real external sector shocks. The reserves of Bangladesh and Nepal increased to record levels recently, with those of Bangladesh climbing to more than $13 billion by early 2013 while those of Nepal crossed $5 billion in late 2012, largely on the back of remittance inflows.

The concern with the large amount of inflows into the region’s asset markets is the macroeconomic
vulnerability this creates if such flows were to reverse. As was seen during the 1997-98 Asian financial crisis, asset market prices could fall drastically and exchange rates could depreciate substantially, leading to the risk of a banking sector crisis as well as drastic loss of wealth of domestic citizens who invested in such assets. The traditional approach of governments in the region to deal with such an eventuality is to accumulate foreign exchange reserves. This method of protection, however, has been seen to be far from ideal. In recent instances when currency support was required, at the time of the start of the crisis, the amount of reserves of countries proved insufficient and some governments such as the Government of Singapore and Government of the Republic of Korea were forced to request precautionary credit lines from the United States Federal Reserve as well as from other regional governments on a bilateral basis.

Calculations regarding the adequacy of reserves compared to the amount of capital outflow may
prove inaccurate, in part due to a lack of full accounting of the size of stock of foreign short-term capital which has built up in economies over recent years. The ESCAP vulnerability measure provides a measure of reserve adequacy taking into account a comprehensive estimate of the stock of such capital inflows. It indicates that a number of economies in the region remain significantly vulnerable to a renewed episode of short-term capital flight (see figure 1.11).

The other key concern pertaining to using foreign reserve accumulation as the primary approach to addressing pressure on economic management from the entry of short-term capital flows is that such an approach does not deal with the impact on asset markets of any sudden outflow. While exchange rate depreciation may be moderated by the use of reserves, equity or property markets could nevertheless decline sharply and substantially, therefore causing hardship for domestic investors and possibly initiating a banking crisis. This problem highlights the fact that foreign reserves accumulation is a second-best approach to dealing with such inflows as it does not tackle them at the source of entry and therefore does not address the various negative impacts within economies of such inflows.

An effective approach for managing disruptive short-term capital inflows is to limit the quantity and areas of the financial sector in which such flows may enter. Capital controls, as recommended by ESCAP for a number of years (ESCAP, 2010a), and other macroprudential measures have been gaining in popularity in recent years as policymakers are increasingly realizing that economies are living with a “new normal” of consistent pressure on their asset markets from foreign investors due to the global environment. To protect the independence of their macroeconomic policies, governments have been willing to give up the dubious benefits of dependence on easily reversible short-term capital flows in order to be able to dictate their own exchange rate policies and protect their citizens and banking sectors from excessive dependence on the whims of the global financial markets.

Uncertainties regarding the causes and effects of inflow surges, as well as the country, sector and time specific aspects defining capital inflows call for a careful strategy towards mitigating possible negative effects. This has been true of the Asia-Pacific region for decades, particularly as more than 60% of past inflow surges have ended suddenly. It is particularly relevant now in the region due to the unpredictable effects demonstrated by successive

![Figure 1.11. Vulnerability yardstick as a percentage of foreign reserves in selected developing Asia-Pacific economies](image-url)


Note: Vulnerability yardstick is the sum of short-term external debt, latest quarterly imports based on four-quarter moving average and estimated international portfolio investment position. Based on latest available data.
rounds of QE. Therefore, countries may need to set capital flow management strategies based on a targeted approach or a combination of tools and incremental time-varying adaptation as elaborated in the ESCAP 2012 Economic and Social Survey of Asia and the Pacific (ESCAP, 2012b).

Preventing the recurrence of devastating boom-bust cycles and the contagion of economic crises require active financial and monetary cooperation at the regional level. The few existing mechanisms, for example, the Chiang Mai Initiative of ASEAN+3, the Asian Bond Market Initiative (ABMI), the ASEAN+3 credit guarantee facility and the Asian Clearing Union, all have partial membership coverage, remain small in scale and are largely still too underdeveloped to effectively act as stabilizers in times of crisis.

The region needs to further develop its financial architecture. This would require a mechanism to intermediate between the region’s large savings and its unmet investment needs, especially for infrastructure development, in order to facilitate trade within the region, to strengthen regional crisis response and prevention facilities, and to build understanding and consensus on global multilateral cooperation. By enhancing regional cooperation, governments would be less compelled to build up large foreign exchange reserves to protect their economies against speculative attacks and liquidity crises, while at the same time this effort would establish the building blocks for global multilateral cooperation.

**Trade performance under threat**

After a strong recovery in 2010, exports from Asia and the Pacific are decelerating, with export growth now below the pre-crisis level. The export growth of the developing Asia-Pacific region dropped from about 35% in 2010 to 13% in 2011, and was about 9% in 2011 excluding exports from China. After mid-2012, trade in the Asia-Pacific region started to contract. Exports from the Asia-Pacific region declined by 2% in the third quarter of last year (see figure 1.12).

Data on imports from the region show a similar contraction, with growth dropping from 35% to 18% from 2010 to 2011, and to 14% in 2011 if imports from China are excluded. Import growth in the Asia-Pacific region declined throughout 2012 while the level of imports stagnated in the third quarter (see figure 1.13), reflecting the region’s slowdown.

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**Figure 1.12. Recent developments in Asia-Pacific export growth**

![Graph showing recent developments in Asia-Pacific export growth](image_url)

*Source: ESCAP, based on World Trade Organization online short-term merchandise statistics (accessed in February 2013).*
Major trading economies, such as Malaysia, the Republic of Korea, Thailand and Taiwan Province of China, have faced a significant slowdown in their exports, starting in the second half of 2011. The supply-chain disruptions due to flooding in Thailand at the end of 2011 affected trade in both the country and the region from the start of the disaster until well into the first quarter of 2012. Exports from Thailand recovered by February 2012 but have subsequently been fluctuating. Moreover, Indonesia, the Republic of Korea and Taiwan Province of China have been confronted with weakening demand from China and the rest of the world, which has resulted in declining growth of their exports from March 2012.

India was able to benefit from its unique trade pattern and record rapid export growth from the second half of 2011 until early 2012, when it then also experienced a steep decline in export growth. The country has been affected by its high specialization in exports of IT-related services combined with weak integration in regional production networks. Consequently, it is vulnerable to the economic uncertainty in the United States and the European Union. With both of these economic powers unable to restart their economic engines, the export performance of India in 2012 was no different from the rest of countries in the region.

The increasing demand for commodities and the strengthening of industrial capacity of emerging economies, especially in industries linked to the extraction of natural resources, have affected the region’s composition of trade. A sector-based analysis reveals that while industrial products still comprise more than 80% of Asia-Pacific trade during 2002-2011, the share of petroleum products increased and agriculture maintained a relatively constant share. All three sectors were similarly hit by reduced demand for their exports, which lost dynamism and recorded growth of less than 10% in 2011. Imports of industrial and agriculture products also decelerated during 2011. On the other hand, energy-intensive activities in the region kept petroleum imports buoyant, with growth of almost 20% during the same period.

The growing consumption in emerging economies in the region has kept imports of consumer goods robust, with an increase of almost 20% recorded in 2011. On the other hand, weak economic conditions in developed markets and associated weakening of growth in the powerhouses of the region, caused imports intended for further production – including processing for exports – to decline much more. For example, imports of raw materials and intermediate goods fell from a 40% growth rate in 2010 to 16%
and 2%, respectively, in 2011. The growth rate in imports of capital goods almost disappeared, collapsing from 32% to a mere 5%, signalling weakening investment activities that, in turn, will have adverse effects on future production.

**Slowdown in China affects the region**

Trade in the region is facing significant new threats from the slowdown of the Chinese economy. China is currently the largest individual export market for the rest of the region. The country accounted for about 16% of exports by the rest of the Asia-Pacific region in 2011. The share for developing economies in the region was slightly lower, with 13.5% of their exports being shipped to China in 2011. About 50% of imports of intermediate goods to China are sourced from developing Asia-Pacific economies and Japan.

Recent data show that China is experiencing difficulties with maintaining its high export growth. After mid-2012, export growth of China decelerated significantly from 10.5% in the second quarter to 4.5% in the subsequent quarter. The growth was weaker on the import side, dropping from about

6.4% to 1.4% during the same period. Apart for the global trade collapse in 2008-2009, these growth rates are the lowest that China has faced in the past decade. This serves as a major factor in determining the intraregional trade outlook.

The decline in the export growth of China is putting a dent in exports from the other regional economies due to their role as suppliers of intermediate inputs for the processing of exports in China. The data provided by General Administration of Customs of China indicates that Chinese exports with high import content are struggling more than those with a high domestic value-added. Thus, export slowdown from China means contractions in the country’s imports of raw materials and intermediate inputs from the rest of the world. Figure 1.14 shows that processing and assembling activities have experienced an export growth contraction since the second quarter of 2011. In these types of exports, import content is very high; China generally provides only assembling services while foreign suppliers provide raw materials, parts or components under a contractual arrangement for subsequent re-exportation of the processed products. Export growth from China recovered somewhat during the second half of 2012, but there remains

<table>
<thead>
<tr>
<th>Figure 1.14. Monthly export growth in China by custom type, 2010-2012</th>
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</thead>
</table>


Custom types are defined by the General Administration of Customs of China.
no indication that this recovery will be sustainable as the two major export markets of China (the United States and the European Union) are still facing subdued prospects.\(^\text{12}\)

The import data reflect the chain reactions indicated on the export side. Imports from China that are for processing and assembling have been declining since early 2011 (see figure 1.15). Imports of equipment used for processing and assembling activities are fluctuating, and growth has mainly been negative. Ordinary imports, such as imports for domestic use, grew rapidly during 2010 and 2011 because of the Chinese economic boom and expansionary policies. However, a contraction of ordinary imports continued throughout 2012, from about 30% during 2011 to negative growth in the second half of 2012, indicating a significant slowdown in the domestic economy.

One option for sustaining the export performance of China would be to encourage product and market diversification. However, in the face of an economic slowdown in traditional destinations, other countries are also seeking increased market shares in non-traditional import markets mostly in emerging economies. Amid global uncertainties, competition in emerging markets will be fierce. Therefore, policymakers need to identify policy mixes that would enable exporters to achieve greater efficiency and trade at lower costs. Cost-cutting through lower wages would be counterproductive as it would likely dampen domestic demand. Therefore, the best route for enhancing competitiveness is by improving productivity. In addition, broadening and strengthening regional economic integration is necessary as this will improve access to Asia-Pacific markets.

The evolving nature of demand in China is a critical factor for the direction of the region’s economic relationships. There is some uncertainty tied to this issue. Policymakers in China have stated that their long-term aim is to improve the "quality of growth" by reducing the excessive dependence of the economy on exports and increasing the role of domestic demand; and within domestic demand, reducing the role of investment, both in infrastructure and recently in the housing sector, and instead boosting the disproportionately small role of consumption. The Government unveiled wide-reaching plans in February 2013 to empower

**Figure 1.15.** Monthly import growth of China by custom type,\(^a\) 2010-2012

![Graph showing monthly import growth of China by custom type, 2010-2012](source)

\(^a\) Custom types are defined by the General Administration of Customs of China.
the poor and reduce inequality with the objective of lifting 80 million people from poverty by 2015. The plans include measures to increase the progressivity of the tax system by increasing the contributions of successful state-owned enterprises, and increase the various elements of tax contribution of the richer members of society. Furthermore, minimum wages in rural areas are to be increased significantly and the household registration system is to be reformed to allow urban residents from rural areas to be entitled to the social security and other entitlements of urban-registered citizens.

ESCAP analysis shows that the improvement of the inclusiveness of growth in China promised by the ongoing reform process, even if it were to result in lower headline GDP growth rates, could have a significant positive impact on economies in the region. Despite a slowdown in headline GDP growth in China, largely as a result of a fall in investment, an increasingly consumption-driven Chinese economy would benefit regional exporters of consumer goods through increased penetration in the Chinese market. The total benefit in exports for the region would be almost $13 billion during the period 2013-2015, with export growth for the region at up to 0.5 of a percentage point above the level without rebalancing (see box 1.3).

**Foreign investment declined, especially in least developed countries**

Due to macroeconomic fragility and policy uncertainty for investors amid the global slowdown, foreign

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**Box 1.3. The impact of a rebalancing China on Asia-Pacific economies**

The twelfth five-year plan of the Government of China explicitly outlines a series of measures aimed at rebalancing the economy away from external dependence and towards a sustainable, domestically driven long-term growth path. Some initiatives that focus on boosting consumption, reducing reliance on exports, reforming financial markets and tackling various other structural impediments are already underway, with more planned to be implemented over the coming years. Due to the importance of Chinese imports to intraregional trade, this is likely to have an impact throughout the wider region. The five-year plan’s aim to reduce the imbalance between consumption and investment may have particularly significant implications for exporters of capital goods as these exports have been largely fuelled by Chinese investment in recent years.

ESCAP conducted multi-year impact assessments for selected Asia-Pacific economies based on a scenario involving the rebalancing of the Chinese economy. Table A shows the likely impact of the rebalancing over the period 2013-2015. In the scenario, the rebalancing of the Chinese economy was compared to its projected long-term growth - the average pace of growth observed in the economy during the past ten years. The scenario assumes that the economy will expand by 8.6% annually during the period 2013-2015, a figure that is 1.7 percentage points less than the long-term trend but is consistent with the estimates reported by the Development Research Center of the State Council, a state agency of China (World Bank, 2012a). As a result of the rebalancing, fixed investment would grow 7.3 percentage points less and consumption would grow 2 percentage points more than what is projected based on the long-term trend. The impacts are reported both in terms of percentage point changes of real export growth and in terms of export benefits or losses. The ESCAP calculations assume that under the rebalancing scenario, the share of China in global consumption will continue to grow at the 1999-2011 average rate, while the share of global consumer goods imports will speed up to grow proportionately with consumption share throughout 2013-15.

ESCAP analysis shows that a rebalancing of the Chinese economy would have overall positive impacts on trade performance of the region’s economies. Despite a growth slowdown, largely the result of a fall in investment, an increasingly consumption-driven economy would benefit exporters of consumer goods through increased penetration in the Chinese market. The total benefit in exports for the region would be nearly $13 billion over the period 2013-2015, with export growth at up to 0.5 of a percentage point above the level without rebalancing.
Table A. Estimated impact of a rebalancing of the Chinese economy on exports in selected Asia-Pacific economies, 2013-2015

<table>
<thead>
<tr>
<th>Region</th>
<th>Impact on export growth (percentage points)</th>
<th>Benefit / loss over 2013-2015 (million $)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>East and North-East Asia</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hong Kong, China</td>
<td>-0.06</td>
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<td><strong>Total</strong></td>
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</table>


Notes: Figures shown are estimated impacts of a rebalancing of the Chinese economy both in terms of percentage point changes of real export growth average during the period 2013-2015 and in terms of benefits and losses during the same period. Although this table does not report estimated impacts for all economies in the Asia-Pacific region, the 29 economies listed above and China cover more than 95% of the region’s total GDP.

direct investment (FDI) in the region declined by 10% to $399 billion in 2012 while globally these inflows fell by 18% to $1.3 trillion (see figure 1.16), (UNCTAD, 2013). The global inflows are currently far short of the $1.98 trillion pre-crisis peak in 2007. Notably, there is the risk that the lacklustre economic performance of the European Union and the United States as well as the slowdown in the regional powerhouses will further depress FDI flows in coming years.

Among the Asia-Pacific developing countries, five economies stand out in terms of attracting FDI inflows. Of these five “FDI giants”, China held the top position with 33% and the second position globally in 2012. Hong Kong, China accounted for a 20% share, followed closely by Singapore and the Russian Federation with shares of 15% and 12%, respectively. India attracted 7% of total FDI inflows to the Asia-Pacific region. The Asia-Pacific developed countries as a group accounted for 12% of total FDI inflows, but these inflows can be mostly attributed to Australia. In this regard, the role of least developed countries remains marginal with less than 1% of inflows going to these countries; this indicates the need for these countries to further improve their attractiveness as investment destinations.

Least developed countries have struggled to integrate into global and regional value chains, mainly due to poor infrastructure, high trading costs and low levels of human capital and technological development. In addition, least developed countries have faced competition from developing countries which also provide an abundance of low-cost labour, but often tend to be more productive (UNCTAD, 2011).

Following the emergence of regional and global value chains in the Asia-Pacific region amid rising levels of regional integration, particularly in the Association of Southeast Asian Nations (ASEAN), intraregional FDI flows have gained in importance. FDI flows among ASEAN countries have more than doubled in share between the periods 1998-2000 and 2008-2010. During the period 2008-2010, the ASEAN+613 countries provided an average of more than 40% of the FDI flows to the subregion compared with an average of 15% during the period 1998-2000. This suggests that intra-ASEAN FDI flows have become an increasingly important source of financing in the subregion. One factor explaining the increase in intraregional investment is that as countries’ industries advance and move up the value chain, they start outsourcing and looking for investment opportunities in other countries.

![Figure 1.16. FDI inflow by regions, 2010-2012](image-url)

The main destination and source countries for intraregional greenfield FDI have changed little in recent years (see table 1.1). Looking back in three-year periods, in 2003-2005, 2006-2008 and 2009-2011, China was the main destination and Japan the main source of intraregional FDI flows. In terms of destinations, the second and third largest countries during 2003-2005, Australia and the Russian Federation, have given way to Viet Nam and India, which have kept their respective second and third positions since 2006. A similar reallocation has taken place among the main source economies. Coming in second and third during 2003-2005, Hong Kong, China, and the Russian Federation have been replaced by the Republic of Korea and China.

The concentration of intraregional FDI in a few countries in the region is an impediment for the region’s least developed countries, which do not attract much global FDI. Therefore, greater efforts by various regional forums are needed to boost intraregional FDI in poorer countries for the balanced and inclusive development of the region. The similarity of socioeconomic conditions among the developing countries in the Asia-Pacific region should encourage companies to look for opportunities in neighbouring countries. Companies that are used to a specific type of business environment should find it easy to trade and invest in countries where conditions are comparable, giving them an advantage over enterprises from developed countries. The smaller technology gap among companies from developing countries puts those firms in a good position to transfer and diffuse technology and knowledge among each other (ESCAP, 2011a).

However, resource-rich least developed countries, such as Afghanistan and Myanmar are attracting FDI in their extractive sectors. Such economies are confronted with the challenge of managing these flows in the most beneficial manner. FDI in extractive industries carries larger risks of corruption, opaque business practices, and undermining development.

### Table 1.1. Main destination economies for Asia-Pacific intraregional greenfield FDI flows, their main sources and share of total flows, 2009-2011

<table>
<thead>
<tr>
<th>Main destinations</th>
<th>Share of total flows</th>
<th>Main sources</th>
<th>Shares of total flows</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>27.6</td>
<td>Japan</td>
<td>24.9</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Taiwan Province of China</td>
<td>23.7</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Hong Kong, China</td>
<td>14.3</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td><strong>63</strong></td>
<td></td>
</tr>
<tr>
<td>Viet Nam</td>
<td>11.5</td>
<td>Japan</td>
<td>43.3</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Republic of Korea</td>
<td>14.2</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Taiwan Province of China</td>
<td>10.6</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td><strong>68.1</strong></td>
<td></td>
</tr>
<tr>
<td>India</td>
<td>10.6</td>
<td>Japan</td>
<td>34.2</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Republic of Korea</td>
<td>30.9</td>
</tr>
<tr>
<td></td>
<td></td>
<td>China</td>
<td>10.7</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td><strong>75.9</strong></td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td>8.3</td>
<td>Japan</td>
<td>28.1</td>
</tr>
<tr>
<td></td>
<td></td>
<td>China</td>
<td>21.6</td>
</tr>
<tr>
<td></td>
<td></td>
<td>India</td>
<td>16.7</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td><strong>66.4</strong></td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>5.4</td>
<td>Malaysia</td>
<td>59.8</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Japan</td>
<td>18.6</td>
</tr>
<tr>
<td></td>
<td></td>
<td>China</td>
<td>7.0</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td><strong>85.4</strong></td>
<td></td>
</tr>
</tbody>
</table>

Source: FDi Intelligence.
efforts in the destination country. Such prospective investors also often demand tax concessions and lower environmental protection. Extractive FDI has also been found to be disruptive for traditional societies. Furthermore, a rapid expansion in the resources sector can lead to the so-called “Dutch disease”,\textsuperscript{15} hampering the competitiveness of economies and hence economic diversification. Therefore, policymakers need to be aware of the risks from FDI in extractive sectors and should design appropriate regulatory measures. It is equally important for resource-endowed countries to improve their business climates and policy environments in order to attract a wider range of FDI in labour-intensive and internationally competitive sectors so as not to become overly reliant on a single sector or industry (ESCAP, 2011a).

**Aid commitments to least developed countries not met**

The challenging global outlook has had particularly important effects for the least developed countries of the region. A significant concern is the reduction in official development assistance (ODA) commitments of the developed world as a direct consequence of the global recession of 2008-2009. Net ODA flows from member countries of the Development Assistance Committee (DAC) of the Organisation for Economic Cooperation and Development (OECD) stood at $133.5 billion in 2011, a decline in real terms of 3\% compared with previous years, widening the delivery gap in meeting the internationally agreed aid target of 0.7\% of GNI to $167 billion (UNDESA, 2013). A total of 16 out of 23 member countries of DAC reduced their aid contributions in 2011, primarily due to the effects on their economies of the global recession of 2008-2009 (United Nations, 2012a). There is a distinct possibility that the proportion of ODA as a percentage of GNI of developed countries will decline further in coming years.

Declining ODA as a percentage of GNI is weakening the likelihood of donor countries reaching other internationally agreed targets. In 2010, this was seen by the inability of DAC countries to meet the G20 Gleneagles target of 0.35\% of their GNI. Furthermore, the 0.35\% target had been regarded as only an interim measure and more achievable target on the road to meeting the target agreed at the United Nations of 0.7\% of GNI.

There is growing evidence that ODA has not only declined in relative scale, but that its focus has shifted from budget support towards project support for many low-income developing economies (UNDESA, 2013). This has raised concerns about the effectiveness of ODA as funding is increasingly fragmented, increases the transaction costs of governments, fails to align with the development objectives of countries, and reduces the country ownership of programmes. The need for aid to be used to meet national development goals has led to growing calls for the reversal of the trend of ODA being increasingly shifted to project support (UNDESA, 2013).

The possible decline in the contribution of ODA in coming years is of particular concern for countries in their efforts to achieve the Millennium Development Goals.

The possible decline in the contribution of ODA in coming years is of particular concern for countries in their efforts to achieve the Millennium Development Goals. There is the risk that fewer countries will be able to meet the Goals as agreed by 2015. The United Nations Millennium Development Goal Gap Task Force has called for governments to meet this challenge by pledging to honour their commitments to increase ODA despite budgetary pressures. As emphasized in the Task Force Report (United Nations, 2012a), such a commitment is in the donor countries’ own best economic and political interests in an increasingly integrated world. Greater development in low-income countries leads to growing markets for trade and investment for developed economies, and creates reduced pressure for migration as living and working conditions improve in sending countries.
Remittances offering a complementary source of resilience

Remittances to Asia and the Pacific continued to increase considerably in 2012. As of 2011, countries in South Asia, South-East Asia and the Pacific receive almost half the estimated remittances in the world (ADB, 2012a). In 2012, the countries of East Asia, South Asia and the Pacific received a record $219 billion in remittances in 2012 (World Bank, 2012b). India and China are the largest remittance-receiving countries in the region in absolute terms, followed by the Philippines (see figure 1.17). The level of dependence on remittances, measured as a percentage of GDP, continues to be significant in the region. Out of the top ten recipients of migrant remittances in terms of volume, five are located in Asia and the Pacific, namely India, China, the Philippines, Pakistan and Bangladesh.

Although still sparse, data availability on remittances is improving. China began to publish quarterly data on remittances for the first time in 2010. The latest data show a surge in remittances to the country for the first three quarters of 2011. Similarly, Thailand revised its historical data on remittance flows upwards, including that for 2011 by $1.8 billion (World Bank, 2011).

Tajikistan tops the remittance dependency ranking in terms of percentage of migrant remittances as a share of GDP (47%) (see figure 1.17). Other countries in the region that are among the global top ten recipients of remittances as a share of GDP are Kyrgyzstan, Nepal and Samoa at 29%, 22% and 21%, respectively. Notably, all of the most remittance-dependent countries in the region are either landlocked developing countries or small island developing States.

Remittances are more resilient to the impact of economic crises compared to other types of private capital and provide protection from associated shocks

Not only are remittances more resilient to the impact of economic crises compared to other types of private capital, they also provide protection from associated shocks. Remittances are often counter-cyclical, rising

Figure 1.17. Remittance inflows in selected Asia-Pacific economies, values and shares of GDP

![Graph showing remittance inflows and GDP share for various countries in the Asia-Pacific region.]


Note: LHS y-axis refers to migrant remittance inflows in billions of United States dollars in 2012, while RHS y-axis refers to remittances as percentage of GDP in 2011.
during economic downturns and natural disasters as migrants increase their transfers of funds in order to provide for their families’ emergency needs. High levels of remittances may significantly complement, or exceed, the government’s social spending as well as ODA. In the year ending in June 2012, Bangladeshis sent home $13 billion, which constitutes more than all the government’s social protection programmes put together (Bangladesh, 2012).

The share of remittances originating in the region itself is significant. In 2010, it accounted for about 34% of total remittances received by countries in the region. The World Bank estimates the figure to be between 26% and 43%, depending on the methodology used. This may explain, partly, why remittance flows were not affected by recessions in advanced countries and political developments in the Middle East. If this is the case, then a generalized slowdown in the region may adversely affect remittance flows.

Even while underestimating the real figures, official remittances are often higher than ODA in many developing economies in the region. For the top remittance-receiving countries, such as India, China and the Philippines, remittances surpassed ODA and FDI inflows. In the Greater Mekong subregion, remittances exceeded ODA and FDI inflows in terms of volume in Viet Nam (Jalilian, 2012).

While the growing comparative role of remittances as a source of funds is welcome, it is important to bear in mind that ODA continues to remain important for developing economies, especially least developed countries, due to the different impact on communities ODA has compared with to remittances. Remittances are valuable as they increase the capabilities of individuals and households, but they do not help in the manner that ODA does with regard to the provision of public goods, such as roads, water supply, education and health care. Therefore, the current curtailment in the magnitude of ODA as a result of the global recession of 2008-2009 in the developed world is of concern.

OUTLOOK FOR ASIA AND THE PACIFIC IN 2013

Moderate growth increase forecast in 2013

The near-term economic performance of the region is likely to pick up in 2013 but still be below its growth potential. Developing Asia-Pacific economies as a group is projected to expand by 6% in 2013, up slightly from 5.6% in 2012 (see table 1.2). Steady, although subpar, growth in the United States, and a rebound, though limited, in most major emerging economies, should help to increase global demand. Within the region, the effects of earlier policy easing and fiscal stimulus will also contribute to higher growth, but any improvement in prospects will be subdued. Leading indicators for industrial activity in major developing Asia-Pacific economies, such as consumer confidence in China, business sentiment in Europe and new orders in the United States, provide mixed signals. Moreover, the expected rebound in 2013 is still below the trend of 7.8% in 2010-2011 and 8.6% during the pre-crisis period of 2002-2007.

ESCAP analysis indicates that lower growth compared with recent years could become a “new normal” for many regional economies if present economic trends were to continue. The output loss could be significant for the region as a whole at almost $1.3 trillion by end-2017. A “new normal” of lower growth may result in 27 out of 43 of economies sampled in the region. Policies to create or strengthen alternative sources of growth should be viewed as a priority in order to prevent the onset of the new normal of lower growth (see box 1.4).

Strong headwinds persist. Factors that have been keeping growth in the Asia-Pacific region at subpar levels were largely unchanged during recent quarters, highlighting lack of improvement in the overall environment. Sluggish world trade volume, partly underpinned by a slowdown in China and India, and subdued commodity prices will continue to hold back growth in export-oriented economies in 2013. Even in economies largely driven by domestic
ECONOMIC AND SOCIAL SURVEY OF ASIA AND THE PACIFIC 2013

Table 1.2. Selected economies of the ESCAP region: rates of economic growth and inflation, 2009-2013
(Percentage)
East and North-East Asiad, e
East and North-East Asia (excluding Japan)d, e
China
Democratic People’s Republic of Korea
Hong Kong, China
Japan
Macao, China
Mongolia
Republic of Korea
North and Central Asiad
Armenia
Azerbaijan
Georgia
Kazakhstan
Kyrgyzstan
Russian Federation
Tajikistan
Turkmenistan
Uzbekistan
Pacific d, e
Pacific island developing economiesd
Cook Islands
Fiji
Kiribati
Marshall Islands
Micronesia (Federated States of)
Nauru
Palau
Papua New Guinea
Samoa
Solomon Islands
Tonga
Tuvalu
Vanuatu
Developed countries (Australia and New Zealand)d
Australia
New Zealand
South and South-West Asiad, f
Afghanistan
Bangladesh
Bhutan
India
Iran (Islamic Republic of)
Maldives
Nepal
Pakistan
Sri Lanka
Turkey
South-East Asiad
Brunei Darussalam
Cambodia
Indonesia
Lao People’s Democratic Republic
Malaysia
Myanmar
Philippines
Singapore
Thailand
Timor-Leste
Viet Nam
Memorandum items:
Developing ESCAP economies
Least developed countries
Landlocked developing countries
Small island developing States
Developed ESCAP economies
Total ESCAP

2009
0.0
6.8
9.1
-0.9
-2.8
-6.3
1.3
-1.3
0.2
-5.3
-14.2
9.3
-3.8
1.2
2.9
-7.8
3.4
6.1
8.1
1.2
2.7
-3.6
-1.3
-0.6
-1.3
0.7
0.0
-4.6
5.5
-5.4
-1.0
3.2
-1.7
3.5
1.2
1.3
0.1
4.0
22.5
5.7
6.7
8.0
1.5
-3.6
3.8
1.7
3.5
-4.7
1.0
-1.8
-2.0
4.5
7.6
-1.7
4.9
1.1
-0.8
-2.2
12.8
5.3
4.6
5.0
4.4
2.4
-5.5
0.4

Real GDP growth
2010
2011
2012 b
6.6
3.5
4.1
9.5
8.0
6.4
10.4
9.2
7.8
..
..
..
7.0
5.0
1.4
3.9
-0.6
2.0
26.4
20.0
9.0
6.4
17.3
12.3
6.1
3.6
2.0
4.6
4.8
3.9
2.6
4.7
7.2
5.0
0.1
2.2
6.4
7.0
7.0
7.0
7.5
5.0
-1.4
5.7
-0.9
4.0
4.3
3.4
6.5
7.4
7.5
9.2
14.7
11.1
8.5
8.3
8.1
2.5
2.5
3.5
4.8
7.9
6.4
0.2
3.4
3.3
-0.2
1.9
2.5
1.8
3.0
3.0
5.2
5.0
1.9
3.1
1.4
1.4
0.0
4.0
4.9
0.3
5.8
4.0
7.1
11.1
9.2
0.2
2.1
1.2
7.1
10.6
5.5
3.3
2.9
0.8
-0.5
1.0
1.2
2.2
4.3
2.0
2.4
2.4
3.5
2.6
2.5
3.6
0.9
1.5
2.5
7.7
6.4
4.1
8.4
5.7
6.9
6.1
6.7
6.3
11.8
11.7
8.5
8.4
6.2
5.0
3.2
4.0
-0.9
7.1
7.0
3.4
4.0
3.8
4.5
3.8
3.0
3.7
8.0
8.0
6.2
9.0
8.6
3.2
8.3
4.5
5.3
2.6
2.2
1.6
6.0
7.1
7.3
6.1
6.5
6.2
7.9
8.3
8.3
7.2
5.1
5.6
5.3
5.5
6.3
7.6
3.7
6.6
14.8
5.2
1.3
7.8
0.1
6.4
9.5
10.6
10.0
6.8
5.9
5.0
8.6
6.0
6.7
5.3
3.7
6.6

7.0
6.6
6.7
7.9
-0.3
4.0

5.6
6.3
5.8
6.2
2.2
4.2

2013 c
4.5
6.8
8.0
..
3.5
2.5
13.5
15.5
2.3
4.0
5.5
1.5
6.0
6.0
7.0
3.6
6.5
8.0
7.0
2.5
3.4
3.0
2.7
3.5
2.3
1.0
8.0
3.0
4.0
0.9
4.0
0.5
1.3
3.2
2.5
2.5
2.3
5.1
6.5
6.0
8.4
6.4
0.8
4.3
4.0
3.5
6.5
3.8
5.4
1.5
7.0
6.6
8.1
5.0
6.3
6.2
3.0
5.3
10.0
5.5

2009
-0.7
0.0
-0.7
..
0.5
-1.4
1.2
6.3
2.8
10.8
3.4
1.5
1.7
7.3
6.8
11.7
6.5
10.0
14.1
1.9
7.0
10.2
6.8
8.8
0.5
8.2
21.2
4.6
7.0
14.6
7.1
1.4
-0.1
4.3
1.8
1.8
2.1
11.0
-8.3
6.7
3.0
12.4
10.8
4.0
12.6
20.8
3.5
6.3
2.3
1.0
-0.7
4.8
0.0
0.6
8.2
3.2
0.6
-0.8
0.7
7.1

2010
1.2
3.2
3.3
..
2.4
-0.7
2.8
10.1
2.9
7.1
8.2
5.7
7.1
7.1
8.0
6.9
6.5
12.0
9.4
2.8
4.8
1.8
5.4
-2.8
1.6
4.3
-0.6
1.2
6.0
-0.2
1.0
3.6
-1.9
2.8
2.7
2.8
2.3
10.0
7.7
7.3
6.1
10.4
12.4
4.7
9.6
11.7
5.9
8.6
3.9
0.4
4.0
5.1
6.0
1.7
7.7
3.8
2.8
3.3
6.9
8.9

Inflationa
2011
2.3
5.1
5.4
..
5.3
-0.3
5.8
9.2
4.0
8.7
7.8
8.1
8.5
8.3
16.9
8.4
12.5
12.0
12.8
3.4
7.5
0.6
7.7
7.7
9.5
7.9
-3.5
2.1
8.5
2.9
7.4
6.2
0.5
0.8
3.4
3.3
4.0
9.4
11.8
8.8
8.3
8.4
21.5
11.3
9.6
13.7
6.7
6.5
5.5
2.0
5.5
5.4
7.6
3.2
4.2
4.8
5.2
3.8
13.5
18.7

2012 b
1.3
2.7
2.7
..
4.1
0.0
6.1
14.3
2.2
5.4
2.6
1.8
-0.9
5.1
2.8
5.1
5.8
8.5
13.2
1.8
3.9
2.8
3.5
-1.8
5.7
5.6
-0.5
6.0
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2.1
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11.0
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8.9
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4.6
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12.0
9.3

2013 c
2.0
3.8
4.0
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4.5
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5.7
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6.8
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3.5
3.1
8.0
8.0

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6.0
5.7
3.8
2.5
4.6

3.6
6.4
8.0
6.3
-1.0
1.7

5.1
7.1
7.9
4.9
-0.3
2.9

6.4
8.4
9.8
8.2
0.1
3.8

5.0
9.3
6.9
5.0
0.2
3.0

5.1
7.1
6.9
6.3
0.6
3.2

Sources: ESCAP, based on national sources; United Nations, Department of Economic and Social Affairs (2013). World Economic Situation and Prospects 2013, Sales No.
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b
c
d
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Changes in the consumer price index.
Estimates.
Forecasts (as of 30 March 2013)
Calculations are based on GDP figures at market prices in United States dollars in 2011 (at 2000 prices) used as weights to calculate the regional and subregional growth rates.
Estimates for 2012 and forecasts for 2013 are available for selected economies.
The estimates and forecasts for countries relate to fiscal years defined as follows: 2011 refers to fiscal year spanning 1 April 2011 to 31 March 2012 in India; 21 March
2011 to 20 March 2012 in Afghanistan and the Islamic Republic of Iran; 1 July 2010 to 30 June 2011 in Bangladesh, Bhutan and Pakistan; and 16 July 2010 to 15 July
2011 in Nepal.

44


Since the global financial turmoil began in 2008, the concept of a “new normal” of lower growth in developed economies has been put forward. The argument is that the reshaping of economies in the developed world will be a medium-term process. Governments are engaging in fiscal consolidation that reduces economic growth, while households and the business and financial sector are also spending less as they rebuild their balance sheets. As growth outcomes in the developed economies and the Asia-Pacific region remain closely linked, a “new normal” growth in the developed economies would also raise the possibility of an extended period of slower growth in the region. Five years since the start of the crisis, this box examines and finds that it is indeed the case that a “new normal” of lower growth is being witnessed in parts of Asia and the Pacific.

Overall, the Asia-Pacific region appears to be experiencing a “new normal” of moderately lower growth. Under assumptions of the continuation of present economic trends, projected and pre-crisis growth rates would differ by about one percentage point per year. In particular, growth in developing Asia-Pacific economies is estimated to decelerate from 7.3% per year during the pre-crisis period of 2000-2007 to 6.4% during the period 2013-17 (see figure A).

Although medium-term growth prospects remain relatively robust in historical terms, this masks two important concerns.

- The crisis-related loss in output is sizeable. As compared to the pre-crisis pace of 7.3% per year, the output level by end-2017 would be more than 10% lower based on the scenario of actual growth during the period 2008-2012 and projected growth of 6.4% during the period 2013-2017. In value terms, the estimated loss amounts to almost $1.3 trillion by end-2017.

- At a country level, several regional economies would suffer from substantially lower future growth than the region as a whole. Figure B plots the medium-term growth outlook against the pre-crisis trend. Most (27 out of 43) Asia-Pacific economies fall below the 45-degree line, which indicates a new normal of lower growth. In Armenia, Azerbaijan, the Islamic Republic of Iran and Samoa, future growth is projected at less than half of the pre-crisis pace, while Pakistan, the Republic of Korea, the Russian Federation and Singapore are also substantially affected.
As expected, economies associated with a new normal of lower growth exhibit greater trade exposure. In the 27 economies that likely face a “new normal” lower growth, goods and services trade accounted for nearly 1.1 times of GDP in the past decade, compared to below 90% of GDP in the other 16 economies. The former group of economies appears to rely more on high-income markets for their export earnings and less on commodity items (food, fuel and ores and metals). But whether stylized facts can be firmly established will require further investigation. After all, economic structure and policy directions of these economies vary noticeably. These problems ahead are not inevitable, with the region having the tools in its own hands to avoid the phenomenon of a “new normal” of lower growth. In addition to diversifying export markets, a widely discussed strategy to avoid the new normal is to boost domestic demand as a new or second source of growth. This is especially critical for more open economies. The progress at present appears gradual (see figure C). The share of total consumption and fixed investment in GDP in Asia and the Pacific has been mostly unchanged since the crisis began, or even lower in open economies, such as Azerbaijan, Brunei Darussalam, Turkmenistan and Taiwan Province of China. Implementation of policies to support domestic demand can be accelerated, including through enhancing the agricultural and services sectors, strengthening small businesses, providing stronger social safety nets to reduce precautionary savings, and upgrading public infrastructure.

Box 1.4. (continued)

As expected, economies associated with a new normal of lower growth exhibit greater trade exposure. In the 27 economies that likely face a “new normal” lower growth, goods and services trade accounted for nearly 1.1 times of GDP in the past decade, compared to below 90% of GDP in the other 16 economies. The former group of economies appears to rely more on high-income markets for their export earnings and less on commodity items (food, fuel and ores and metals). But whether stylized facts can be firmly established will require further investigation. After all, economic structure and policy directions of these economies vary noticeably. These problems ahead are not inevitable, with the region having the tools in its own hands to avoid the phenomenon of a “new normal” of lower growth. In addition to diversifying export markets, a widely discussed strategy to avoid the new normal is to boost domestic demand as a new or second source of growth. This is especially critical for more open economies. The progress at present appears gradual (see figure C). The share of total consumption and fixed investment in GDP in Asia and the Pacific has been mostly unchanged since the crisis began, or even lower in open economies, such as Azerbaijan, Brunei Darussalam, Turkmenistan and Taiwan Province of China. Implementation of policies to support domestic demand can be accelerated, including through enhancing the agricultural and services sectors, strengthening small businesses, providing stronger social safety nets to reduce precautionary savings, and upgrading public infrastructure.

China and India are expected to rebound somewhat after a sharp slowdown in 2012. China is forecast to grow by 8% in 2013, slightly higher than 7.8% in 2012, but 0.8 of percentage point lower than the 2012 forecast provided in the Economic and Social Survey of Asia and the Pacific 2012 (ESCAP, 2012b) released in May. Growth in India in 2012 was notably lower than previously forecast, but the economy is projected to recover moderately to 6.4% in 2013. Improved, although still tepid, global trade should help to support growth in export-led economies in East and North-East Asia and South-East Asia. For example, growth in Hong Kong, China, the Republic of Korea and Singapore is projected at around 2.3-3.5% in 2013, up from 1.4-2% in 2012. Meanwhile, growth in North and Central Asia is likely to remain stable, benefiting from elevated global energy prices and sustained growth in the


demand, which proved to be rather resilient in 2012, employment and earnings growth in 2013 are likely to remain constrained. Macroeconomic management in these outperforming economies and in economies with relatively free capital movements will also be complicated by the recent liquidity injections in developed economies. These liquidity injections have already intensified capital flows and domestic currency volatility in some economies of the region. In general, the potential effects of volatile short-term capital flows warrant close surveillance.
Russian Federation. Renewed growth in India and healthy domestic demand should help to push up growth in South and South-West Asia. In contrast, developing Pacific island economies are likely to continue to face sluggish growth. As a group, Pacific island economies growth is projected to decelerate in 2013 due to a sharp, energy sector-led slowdown in Papua New Guinea which is by far the largest Pacific island economy. However, demand from Australia and New Zealand should remain reasonably strong.

Despite the moderation in growth in the region as compared to previous robust rates, Asia and the Pacific still remains the most dynamic region globally and exerts increasing influence on other developing regions. The region is forecast to grow in 2013 at a rate far more rapid than not only the developed regions of the world, but also compared to other developing regions (see figure 1.18). The growing economic weight of the Asia-Pacific region has led to increasing interaction with other developing regions, most notably Africa and Latin America. However, in this regard, there remains significant unfulfilled potential. ESCAP analysis indicates that global South-South exports could increase by an additional $194 billion during 2013-2014, if trade costs of low-performing developing countries could converge by one-fifth towards the levels of high-performing developing countries through greater South-South cooperation in trade facilitation and logistics services and infrastructure development (see box 1.5).

**Modest inflation forecast for 2013**

The inflation forecast is generally modest in 2013, with prices projected to increase by 5.1% in the region (see table 1.2). Although inflation is not poised to rise sharply, it is important to note that prices are high, causing severe hardship to the poorest and most vulnerable sectors of society in many economies. Furthermore, while overall inflation may not rise for many economies, the key food and fuel sectors may face price pressure due to global supply concerns. The overall moderate outlook for inflation is due to growth remaining relatively weak, resulting in reduced domestic demand-pull factors and inflationary expectations. The inflation outlook is conducive for loosening monetary policy, but such an approach needs to be accompanied by active macroprudential policies and capital controls to prevent external-led pressures on asset prices. Moreover, monetary or credit expansion should be carefully designed to support SMEs, agricultural production and environmentally friendly industries.
Box 1.5. Lowering trade costs to spur South-South integration

As highlighted in the *Survey 2012*, South-South trade and investment has become increasingly important in the global economy. South-South exports grew by 19% annually in 2010-2010, compared to 12% for world exports. However, the latest ESCAP-World Bank Trade Cost data reveal that developing countries continue to suffer from significantly high trade costs (see figure A). For instance, it costs 2.5 times more for an economy of South-East Asia to trade with Africa than with North America.

By inferring trade costs from the observed pattern of production and trade across countries, the new ESCAP-World Bank Trade Cost data capture not only international transport costs and tariffs but also other potential cost components, such as differences in languages, currencies and import or export procedures. It is also comprehensive, covering 178 countries, including a wide range of developing countries, over the period 1995-2010.

Figure A. Average trade costs, 2007-2010, in percent ad valorem equivalent (international relative to domestic trade costs)

The trade cost data also reveal considerable disparity among developing countries, with areas such as East Asia exhibiting much lower levels of trade costs than, for example, Africa. A clear policy implication is that South-South cooperation could be improved to lower trade costs. In particular, cooperation in improving trade-related procedures, infrastructure and services could be enhanced in line with the recent trade literature which finds non-tariff trade costs to be significant determinants of trade flows.

In fact, South-South development cooperation, whose net disbursement was estimated at $12.1 billion in 2006, has expanded rapidly, including in trade related areas. For instance, the development cooperation by China of $1.9 billion in 2009 was nearly four times the 2000 level, with 45.7% of it going to Africa and 12.7% of it to Latin America and Caribbean. Of the 2,025 completed projects under grants or interest-free loans, 390 were in transport, power supply and telecommunications. Technical cooperation, export credits and special loans for SMEs are other important contributions related to trade.

Source: ESCAP, based on ESCAP-World Bank Trade Cost database.

Note: NEA=Northeast Asia, SEA=Southeast Asia; LAC=Latin America and Caribbean.
Box 1.5. (continued)

Given the above, ESCAP analysis shows that if South Asia, Africa and Latin America and Caribbean, whose trade costs remain significantly high, could improve their trade logistics performance closer to the levels of their East Asian peers, their total exports could increase by an additional $238 billion over 2013-2014, of which $194 billion dollars would be in South-South exports (see figure B). The findings clearly indicate the potential of South-South cooperation to enhance the trade capacity of low-performing developing countries.

**Figure B. Additional South-South exports in 2013-2014, in billions of dollars (right) associated with improvements in trade logistics, in Logistics Performance Index (LPI) scores (left)**

This analysis is unique in that it applies recent estimations of export-cost elasticity in the context of narrowing the gap in trade costs among the world’s major developing regions. In line with recent trade literature, the ESCAP analysis uses the Logistics Performance Index (1=low to 5=high) as a proxy for trade costs and assumes an export-cost elasticity of 0.5. Taking East Asia as a benchmark, the analysis assumes that South Asia, Africa and Latin America and Caribbean would each narrow the differences in LPI scores by one-fifth. Baseline export volumes are calculated using 2011 export volumes from the World Trade Organization (WTO) and 2012-2014 export growth projections from the United Nations Department of Economic and Social Affairs. The share of South-South exports in total exports of South Asia, Africa and Latin America and Caribbean are taken from the United Nations Conference on Trade and Development.

a Hoekman and Nicita (2008) find a one point reduction in the Logistics Performance Index score (1=low to 5=high) to be associated with some 50% increases in both export and import volumes. Similarly, Arvis, Duval, Shepherd and Uktotham (2012) find a 10% improvement in the Liner Shipping Connectivity Index score (max. value in 2004=100) to be associated with a 3.8% decrease in trade costs.

b ECOSOC (2008) estimated net disbursements of Southern development cooperation in 2006 at $12.1 billion, with China, India and Brazil contributing between 0.04% and 0.11% of their GNI to ODA. Similarly, Zimmerman and Smith (2011) estimate that gross development flows from selected countries beyond the OECD/DAC stood at nearly $11 billion in 2009, representing approximately 8% of global gross ODA.

c China, Information Office of the State Council (2011).

**Downside risks**

Overall risks for the growth forecasts in 2013 remain tilted to the downside. A key downside risk is a sharper-than-expected economic slump in Europe. Although the region’s direct financial exposure to banks in the euro zone is not sizeable, systemic risks could rise further under this scenario. Fiscal policy uncertainty in the United States, commodity price hikes due to heightened global financial liquidity and continued geo-political risk in oil-producing areas, and possible food price hikes due to droughts in major food-producing countries pose additional risks. Within the region, the pace of growth deceleration in China and its implications for the direction of domestic policy, such as through rebalancing the economy’s sources of growth and property market corrections, as well as a return of economic dynamism in India, are important. On the upside, there is room for macroeconomic policy responses to counteract the
strong and persistent headwinds in most economies. Better policy coordination in developed economies and well-directed policy stimulus in China and other export-oriented economies would reduce economic uncertainty, and potentially push growth in the Asia-Pacific region above the baseline. Enhanced regional cooperation in finance, trade, infrastructure investment, food and energy security and labour migration matters can also play a crucial role in ensuring sustained and inclusive development.

STRUCTURAL IMPEDIMENTS TO CONTINUED PROGRESS

The generalized slowdown across the region in 2012 raises the concern that, beyond the problems emanating from the developed world, there are shortcomings even within domestic economies in terms of the developmental strategies being pursued. Among others, these include unsustainable resource use rates, growing inequality, declines in public infrastructure investment, especially in agriculture, and low government revenues. These structural impediments exacerbate risk and vulnerability related to food, energy and commodity price increases, as well as to economic instability and slowdown. The need to focus on removing structural barriers to allow domestic demand to contribute more effectively to development is heightened further by the expectation that the export channel to the developed world will be less important for an extended period.

Growing inequality is threatening shared prosperity and constraining domestic markets

Sustained output growth has halved the mean poverty headcount (the proportion of people living on less than $1.25 per day) in Asia and the Pacific from 52% to 19% between 1990 and 2010 (ESCAP, ADB and UNDP, 2013). However, declines in poverty in the region have been accompanied by greater levels of inequality (see figure 1.19), with the population-weighted mean Gini coefficient for the entire region increasing from 33.5% in the 1990s to 37.5% in the latest available year. Only 16 out of 30 countries that enjoyed positive mean annual growth over the long run exhibited lower income inequality. Notably, inequality has increased in the East and North East Asia, North and Central Asia, and Southeast Asia subregions, with the increase varying across the subregions.

The above findings by ESCAP are in line with other recent studies, such as that of the Asian Development Bank (ADB) (ADB, 2012a), which finds that inequality widened in many countries of the region in the past two decades. According to the ADB study, inequality widened in 11 of the 28 economies with comparable data, including the three most populous countries, and in the drivers of the region’s rapid growth—China, India, and Indonesia. From the early 1990s to the late 2000s, the Gini coefficient worsened from 32% to 44% in China, from 31% to 37% in India, and from 29% to 39% in Indonesia.

Inequality is important because of its negative impact on development outcomes, as seen by discounting levels of development achievement by a factor proportional to the extent of inequality (Sen, 1976) and (UNDP, 2011). For example, per capita GDP declines from $2,208 to $1,391 (in 2005 PPP) in India when adjusted for inequality (see figure 1.20-A). In the case of Malaysia, the decline is from $12,526 to $6,738. Inequality also reduces the poverty reduction impact of economic growth. Poverty declines at a faster rate for a given growth rate of GDP if inequality declines at the same time than when inequality does not change or rises.

Results from the updated ESCAP Social Development Index first presented in the Survey 2012 (ESCAP, 2012b) clearly highlight the importance of reducing income and social inequalities for increasing equitable, inclusive and sustainable development in the region. The ESCAP Social Development Index combines the education and life expectancy components of the Human Development Index. Using data for 25 Asia-Pacific countries in 2011, each dimension’s average value can be discounted according to the country’s level of inequality in
This indicates that the discount is particularly high in emerging economies, such as China, India, Indonesia and Turkey, where this inequality-adjusted social development index shows an average potential loss of more than 20%.

Inequality of opportunity was also found to be common across the region, particularly in physical assets, such as capital and land, human capital, such as education and health, market access, such as labour and finance, and other public services, such as electricity, water and sanitation. In South-East Asia, for instance, there is a worrisome lack of access to education for income-poor families, with the incidence of education deprivation being 34 times worse in the Lao People’s Democratic Republic for the poorest quintile than the richest.
quintile and seven times worse in Thailand (UNICEF, 2011b). In South Asia undernutrition among children decreased only slightly, from 64% in 1995 to 60% in 2009 for the poorest 20% of the population as opposed to a large decrease from 37% to 26% among the richest 20% during the same period (ADB, 2012b). Significant disparities in access to social services within countries are also stratified by area of residence and by gender.

Lack of progressivity in tax structure and insufficient public provisioning contributing to inequality

Inequality in the region has been exacerbated by the failure of fiscal policy to play its distributional role through making the tax structure more progressive and providing for increased expenditure in the public provisioning of essential services, including social protection. Many economies in the region have failed to raise sufficient tax revenue despite rapid growth, as demonstrated by their low and stagnant tax-to-GDP ratios (see figure 1.21). The stagnant tax-to-GDP ratios when the economy was growing indicate lack of sufficient progressivity of the tax structure.

In fact, the Asia-Pacific economies as a group have the lowest tax burden of any developing region in the world (Park, 2012). The dependence of the region’s economies on direct income taxes as opposed to indirect value-added taxes is lower than many countries and far below that of the OECD economies as a whole (Park, 2012). Declines in formal employment and the consequent rise in vulnerable employment are also contributing to the growing inequality through the falling share of wages in GDP. There is a clear negative relationship between the tax burden of countries in the region and their levels of inequality (see figure 1.22).

The negative relationship is more pronounced between public social expenditure and levels of inequality (see figure 1.23). In spite of significant progress in recent years in a number of countries, including through extending provision of basic health-care access and income support to poor workers and households, Asia-Pacific countries still exhibit significant shortcomings in their social protection regimes. Public social security expenditure remains low at less than 2% of GDP in one-half of the countries where data are available (see figure 1.24). In addition, only 30% of persons above the retirement age in Asia and the Pacific receive a pension on average, while only 10% of the unemployed receive any benefits (ILO, 2010c) and (Bonnet, Saget and Weber, 2012).

Vulnerable employment is a persisting issue within the Asia-Pacific region. Despite high rates of economic

![Figure 1.21. Tax-to-GDP ratio in selected developing Asia-Pacific economies](source: ESCAP, based on data from CEIC Data Company Limited. Available from http://ceicdata.com (accessed on 8 February 2013).)
growth in East Asia, more than half (50.8%) of the region’s workforce maintains vulnerable employment status. Such figures are significantly worse in South Asia where vulnerable employment is more than 78% (ILO, 2011a).

Vulnerability of employment and inequality are both inimical to domestic demand. As shown above, inequality and vulnerability have been exacerbated by the failure of governments to raise tax revenue through a progressive tax structure. This has constrained their ability to spend on basic social services, including social protection. Progressive taxation and social protection measures not only reduce inequality, but also lessen vulnerability by acting as automatic stabilizers. The low tax revenue...
restricts governments’ fiscal space and hence their ability to boost domestic demand when needed. Therefore, reform of the tax structure, including raising efficiency in tax administration and widening of the tax base are of utmost urgency for most Asia-Pacific countries, especially when they have to find domestic drivers of growth in the face of diminished prospects for exports.

Low tax revenues constrain ability for countercyclical response and public investment

The Asia-Pacific region suffers from large infrastructure deficits, although there are significant variations among countries (see tables 1.3 and 1.4). China has near universal access to the electricity network compared with access for only 40% of the population in India. Least developed countries of the region, such as Afghanistan, Cambodia and Myanmar have the largest infrastructure deficits. Even relatively developed Asia Pacific countries suffer from infrastructure shortage as compared to advanced countries. For example, per capita electricity consumption in OECD countries is around 10,000 kWh, whereas in Indonesia, it is 600 kWh, and outside the island of Java, less than 400 kWh. Only 12% of the country’s population has access to piped water.

Infrastructure deficit is clearly an impediment to growth, especially in South Asia and the Pacific islands. Investment Climate Assessment surveys of firms in South Asia shows that lack of infrastructure is a “major” or “severe” obstacle to business expansion, ranging from approximately 33% in India to about 80% in Bangladesh. Power is the most critical bottleneck, with transportation a close second. Traffic congestion has become a common feature in most Asian cities; its costs can be as high as percentage points of GDP. For example, Indonesia is losing about 1.2% of its GDP yearly due to severe traffic jams (Indonesia, 2010), while traffic congestion in Bangkok is responsible for a loss of 2.1% of GDP of Thailand (Willoughby, 2000). In 2008, the annual road congestion costs in the Republic of Korea reached 26.9 trillion Korean won (approximately $23.8 billion), more than 2.6% of the country’s GDP (Korea Transport Institute, 2010).
Table 1.3. Comparative indicators of infrastructure in East Asia and the Pacific and in South Asia, latest available data

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<td>Water (percentage of population with access to improved water source)</td>
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Table 1.4. Comparative indicators of infrastructure in selected Asia-Pacific economies, latest available data

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<th>Telephone lines</th>
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Notes: Electricity (percentage of population with access to electricity); water (percentage of population with access to improved water source); sanitation (percentage of population with access to improved sanitation); telephone lines (per 100 people), mobile subscribers (mobile cellular subscriptions per 100 people), Internet users (per 100 people); road density (km of road per 100 sq. km of land area).
Neglect of agricultural sector contributing to poverty, inequality and food insecurity

The neglect of the agricultural sector in the region over past decades has had serious impacts on poverty, inequality and food security of citizens. Agriculture accounts for a quarter of GDP of the developing economies of Asia and the Pacific, employs about 60% of the region’s working population and shelters a majority of the poor. Thus, the importance of the agricultural sector is clear. The neglect of agriculture has contributed to the high and volatile food prices seen in the region in recent years. It appears that those countries with significantly high food insecurity, measured by the proportion of people undernourished, also spend far less on social welfare and agriculture. For example, the countries with the highest proportion of undernourished during the period 2010-2012 - Bangladesh (16.8%), Cambodia (17.1%), India (17.5%), Nepal (18%), the Philippines (17%) and Sri Lanka (24%) - spend about 1% of their GDP on agriculture.

The neglect of agriculture has weakened the sector’s capacity to cut poverty and inequality. The neglect of agriculture in government policy was analysed in the ESCAP 2008 Economic and Social Survey of Asia and the Pacific (ESCAP, 2008). The 2008 Survey noted that “growth and productivity in agriculture have stalled, and the green revolution that boosted agricultural yields in the 1970s has bypassed millions. Farmers are now facing mounting pressure, evident in declining subsidies, rising input prices, intensifying protests over landlessness and an alarming number of suicides among the indebted”.

This neglect has weakened the sector’s capacity to cut poverty and inequality. The number of people whose livelihood depends on agriculture has not declined as rapidly as the share of agriculture in GDP. So, less income in agriculture has had to be shared by more people. In addition, the land Gini coefficient is high (around 0.6) in many developing countries of the region, implying that the income generated in agriculture is not shared equitably.

The region has seen a sharp drop in agricultural productivity growth which has been due in significant part to structural factors. Average annual agricultural labour productivity growth in the Asia-Pacific region declined from 2.5% in the 1980s to 2.2% in the 1990s and to 1% during the period 2000-2002. Growth in average annual land productivity also declined, from 8.5% during the period 1961-1994 to 3.5% during the period 1994-2000 and then to 2.1% during the period 2000-2003. Structural impediments for productivity growth in agriculture include lack of human capital development due to limited access to health and education, inequality in land ownership, and inadequate rural infrastructure. These impediments are largely due to anti-agricultural macroeconomic policies that resulted in declines in public investment in agriculture, especially in research and development and extension services, and cuts in agricultural credit and input subsidies.

Macroeconomic policies that encouraged speculative activities in stock markets and created property booms discouraged private investment in agriculture as big landowners waited for property developers to buy up their land. This has not only hampered agricultural productivity growth, but has also reduced arable land at an alarming rate, especially in the urban fringe areas.

The neglect of the rural and agricultural sector is evident from the inequalities in access to health and education and infrastructure. For example, nearly a quarter of the rural population in the region does not have access to safe drinking water, as opposed to 7% in urban areas. Less than a third of people in rural areas have access to improved sanitation, in comparison with 70% in urban areas. Similar gaps also exist in access to education. For example, illiteracy in China stood at 116 million adults in 2005, with those affected mainly from rural areas (Illiteracy, 2007). In South Asia, the share of the rural population living more than two kilometres from an all-weather road stood at 35% in 2006 (ESCAP,
2006). Access to electricity is not available for more than a billion people in Asia and the Pacific, the majority of which are rural poor.

Rural farmers have found their access to finance constrained, in particular as a result of the structural adjustment programmes of the 1980s as well as the removal of subsidized credit schemes. With financial deregulation and changes in monetary policy, schemes of specialized credit and agricultural refinance operated by central banks are no longer available. Rediscount rates are now set by many central banks and specific sectors are not directly supported. Lending for agriculture by commercial banks is naturally curtailed in response to low returns and lack of availability of collateral.

Expenditure on agricultural research and development in Asia-Pacific remains much lower than in developed countries

While expenditure on research and development in the Asia-Pacific region has gradually increased, it remains much lower than in developed countries. Furthermore, in some countries it either declined or remained stagnant. In China, research and development spending decreased in 2000 to 0.4% of value-added in agriculture from 0.57% in the early 1960s. In Thailand, there has been little increase over the decades, with research and development spending remaining at 0.4-0.5% since the 1970s, though there has been some recent upward movement. India increased its research and development expenditure in the 2000s from 0.18% of agricultural value-added to 0.34%.

The share of the private sector in agricultural research and development in the Asia-Pacific region is appallingly low at approximately 8% compared with about 54% in developed countries. Therefore, governments have to play a much larger role in lifting agricultural productivity by investing in research and development, rural infrastructure and extension services as well as improving access to education and health for improving human capital.

Improvement in agricultural productivity is critical for not only insulating the region from the volatility of global markets and enhancing food security, but also to reduce poverty and inequality. ESCAP estimates show that a 1% increase in agricultural productivity would lead to a 0.37% drop in poverty in the Asia-Pacific region (ESCAP, 2008). Given the large agricultural labour productivity gaps among countries in the region, the potential gains would be substantial. For example, raising the region’s average agricultural productivity to the level of Thailand, could take 218 million people out of poverty. India has the most to gain from accelerated agricultural productivity growth, with nearly two-thirds of the region’s poor and a large agricultural productivity gap. In this context, in past years, ESCAP highlighted the need for a second “green revolution” based on sustainable agriculture to raise the region’s agricultural productivity (ESCAP, 2009b; and 2010a).

Unsustainable resource use

Industrialization and an expanding and increasingly affluent consumer base have boosted the demand for all kinds of resources. Trends in the use of biomass, energy, construction and other minerals show that while the economies of other regions of the world are becoming less resource-intensive over time, the Asia-Pacific economy is requiring more resources to produce one dollar of GDP as the economy grows (see figure 1.25). One factor behind this is the still-significant unmet needs of developing countries in the region. However, a large part can be attributed to economic growth strategies employed by countries. Notably, the region as a whole in 2008 used almost twice the input of resources\textsuperscript{16} to create one unit of GDP as the global economy.

Figure 1.26 shows that while the per capita domestic material consumption in the Asian and Pacific region is still below that of the world, the gap narrowed significantly between 1992 and 2008. The use of resources in economies in the Pacific, East and North-East Asia and North and Central Asia which have more affluent lifestyles, rely heavily
on production of commodities and energy and/or are in a process of rapid infrastructure expansion. This contrasts significantly with the low per-capita use of resources in economies where poverty persists, such as in South and South-West Asia. Future growth of resource use in such countries holds significant implications for overall resource demand.

Construction minerals account for approximately 70% of resource use as of 2005, and is the fastest growing category of material use. Biomass accounts for a diminishing proportion of resource use overall, but total resource extraction has increased by a factor of three from 1970 to 2005. This has been primarily influenced by changing lifestyles and changing consumption patterns, including increased consumption of animal protein.

The demand for biomass directly influences changes in land cover, and increases risks related to flooding, landslides, biodiversity loss and localized climate impacts. The climate impacts are shown in the dramatic loss of primary forests across the region to agro-industry and forest plantation. Regional plantation forests make up almost the same area as

**Figure 1.25. Domestic material consumption intensity, Asia and the Pacific, its subregions and the world, 1992 and 2008**

**Figure 1.26. Per capita domestic material consumption, Asia and the Pacific, its subregions and the world, 1992 and 2008**

Sources: Commonwealth Scientific and Industrial Research Organisation and UNEP Asia Pacific Material Flows database.
primary forests, the highest proportion in the world, and three times the global proportion. South-East Asia has lost 13% of its forest area over the past 20 years, with the net loss of forest amounting to an area roughly equal to the size of Viet Nam.

Of particular concern in the context of climate risks is the intensity of water requirements. Because of the heavy dependence of economies of the region on agriculture, the water intensity of most Asia-Pacific subregions far exceeds the global figure (see figure 1.27). This signals continued pressures on water resources, vulnerability of these economies to drought, and declining capacity of freshwater systems to meet ecosystem services requirements, including the provision of food to rural communities. While growing affluence is mainly to blame for environmental pressures related to resource use, persistent inequality with regard to the lack of access to basic services is also a factor. Some 800 million people are without access to modern forms of energy, mainly in rural areas. Specifically, the lack of access to electricity limits overall socioeconomic progress and perpetuates a vicious cycle in which the need for wood and other biomass-based forms of energy promotes extraction from the natural environment. This problem is particularly prominent in South Asia, where the annual extraction of wood for fuel wood use has stayed relatively constant for the last forty years, in contrast to declining rates in other regions, and is linked to the low levels of access to modern forms of energy in that subregion.\textsuperscript{17}

### The perception that intensive resource use and environmental degradation are acceptable phenomena is imposing significant socioeconomic costs

The perception that intensive resource use and environmental degradation are acceptable phenomena in a “grow now, clean up later” approach to development is imposing significant socioeconomic costs – costs that are most often borne by the most vulnerable in society. Extensive deforestation was partially blamed for the flood crisis of 2010 in Pakistan that affected one and a half million people. One out of four deaths globally is attributable to environmental causes, such as polluted air, contaminated water and lack of adequate sanitation (WHO, 2006b). According to a World Bank estimate, China is losing about 5.8% of its GDP due to air and water pollution (World Bank, 2007). In India, 2.6 million premature deaths a year are related to air pollution, contaminated drinking water and other environmental risks (López, Thomas and Wang, 2008).

Extreme weather events, which may be related to climate change, add to these costs. While the region generates 25% of the world’s GDP, it has suffered

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**Figure 1.27. Water intensity, Asia and the Pacific and its subregions, 2000**

![Water intensity, Asia and the Pacific and its subregions, 2000](image-url)

**Sources:** Commonwealth Scientific and Industrial Research Organisation and UNEP Asia Pacific Material Flows database.

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59
42% of the global economic losses due to natural disasters (ESCAP and UNISDR, 2012). The cost of the 2011 floods in Thailand, for example, was estimated at $45 billion, and recovery and reconstruction at $25 billion (Tang, 2011), while GDP declined by 9% in the last quarter of 2011 compared with the previous year (Thailand, 2012). These losses will continue as climate change deepens and accelerates. ADB estimates that in South-East Asia, the economic cost of climate change could be equivalent to a loss of 6.7% of GDP per year by 2100 – more than twice the world average (ADB, 2009).

Economic losses are just one facet of the implications of resource-intensive growth patterns for development. The ESCAP-ADB-UNEP joint publication, Green Growth, Resources and Resilience (ESCAP, ADB and UNEP, 2012) points out that while there is need to continue to elevate the standard of living, this must be achieved based on resource efficient, rather than resource-intensive growth strategies. In a context of high and volatile resource prices and increasingly evident resource constraints, a resource-intensive growth pattern translates to an economy with higher exposure to risk, especially for the most vulnerable in society. Resource efficiency is increasingly an economic risk management strategy on both economic and social fronts. This is acknowledged in national development strategies in the Asia-Pacific region as well as elsewhere.

Figure 1.28 highlights the growing dependence of each subregion of the Asia-Pacific region with the exception of the Pacific subregion (which includes Australia) on resources sourced from other parts of the world. This dependence presents an emerging source of vulnerability – the vulnerability of the economy to disasters or other events that may constrain access to resources increasingly sourced from other parts of the world.

Resource-intensive growth is a result of a combination of factors, including lack of access to resource efficient technologies. There are also policy failures, such as fiscal policies and market prices that do not reflect the true cost of resources or the pollution that resource use generates, as well as over-emphasis on resource-intensive export-led growth. An analysis of the factors that have contributed to resource-intensive growth also shows that technological advances have not led to efficiency improvements and are highly unlikely to mitigate future environmental pressures. Fiscal incentives for sustainable production and consumption, public investment in innovation of resource efficient and green technologies and expanding access to basic services based on resource-efficient models are

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**Figure 1.28. Physical trade balances in Asia-Pacific subregions, 1975, 1990 and 2005**

![Graph showing physical trade balances in Asia-Pacific subregions, 1975, 1990 and 2005.](image)

*Sources: Commonwealth Scientific and Industrial Research Organisation and UNEP Asia Pacific Material Flows database.*
essential for mitigating further risk and ensuring equitable access to resources and opportunity for development. Many smaller countries, especially least developed countries, cannot address these issues by themselves—thus, regional cooperation is critical.

**Increased disasters costing lives and development**

Asia and the Pacific is the world’s most disaster-prone region and the Pacific islands subregion is the most disaster-prone subregion in the world. In 2012, floods and storms were the most frequent types of disasters occurring in the region and had the highest human and economic impact, accounting for 54% of the death toll, 78% of people affected and 56% of all economic damages due to disasters. Pakistan suffered large-scale losses from floods for the third successive year. Floods in China affected more than 17 million people and caused the highest economic losses ($4.8 billion). In South Asia, South-East Asia and East Asia, they accounted for 57% of total deaths, 74% of affected people and 34% of the total economic damages caused by disasters in the first ten months of 2012, amounting to an estimated $15.1 billion (UNISDR, 2012). The disaster losses in 2012 were relatively much lower in comparison to 2011, the year in which the Great East Japan Earthquake, tsunami and the ensuing nuclear disaster occurred, as well as the South-East Asian floods, which contributed to the staggering $294 billion in regional economic losses—representing 80% of global losses due to disasters in 2011 (see figure 1.29). Large-scale post-disaster recovery and reconstruction efforts have been taken up in 2012 in Japan and Thailand.

The Democratic People’s Republic of Korea, Sri Lanka, the Philippines, China and Pakistan, all of which suffered from extensive floods for the third successive year, were among the top five ranking countries in 2012 as per the total number of people killed and affected by disasters per 100,000 inhabitants (UNISDR, USAID and CRED, 2012). Typhoon Bopha was the strongest tropical cyclone to ever hit the island of Mindanao of the Philippines. Cyclone Evan, which severely affected Fiji and Samoa, was considered to be the worst tropical cyclone to affect Samoa since 1991.

Vulnerability to disasters continues to increase while economic development is exposing ever-growing numbers of people and assets to disasters. The Asia Pacific Disaster Report 2012: Reducing Vulnerability and Exposure to Disasters (ESCAP and UNISDR, 2012), published by ESCAP in partnership with UNISDR, provides recent analysis of these trends. From 1970 to 2010, the population in Asia and

![Figure 1.29. The profile of economic damages due to disasters in Asia, 1980-October 2012](source: EM-DAT: The OFDA/CRED International Disaster Database. Available at www.emdat.be.)
the Pacific almost doubled from 2.2 billion to 4.2 billion. In the same period, the average number of people exposed to yearly flooding more than doubled from 29.5 million to 63.8 million and the number of people living in cyclone-prone areas also went up, from 72 million to more than 120 million people.

Disaster losses since 1980 have increased by 16 times in Asia while GDP per capita has grown by only 13 times. The rate at which wealth is being lost is faster than the rate at which it is being generated. Never before has the need for collaborative action to reduce risk, vulnerability and exposure of populations and assets been more obvious and necessary for the common good. The shared challenge in Asia and the Pacific is to control both the growing rate of exposure and rising vulnerability. Exposure to hazards has multiplied as urban centres grow and people and economic activities expand into increasingly exposed and hazard-prone land. It is also a concern that smaller economies, those that have less diversified economic structures, and countries with high fiscal deficits, show greater vulnerability even when faced with relatively small-scale disasters.

Well-targeted investment in disaster risk reduction and management can reduce vulnerability and exposure to disasters. Social protection, designed in a more resilient manner by taking into account poverty alleviation and focusing on the underlying causes can reduce people’s vulnerability during and after a disaster event. Scaling up vulnerability reduction measures in high-risk areas, land-use planning, supply chain management and targeted social safety nets for the most vulnerable have the potential to reduce disaster risks significantly. Furthermore, regional cooperation can be used for cost effective sharing of highly sophisticated and sometimes costly ICT and space technologies. Guiding principles for policymaking should be to focus on development strategies that reduce exposure to hazards and to invest more in disaster risk reduction policies to achieve greater resilience against disasters.

POLICY OPTIONS

Supporting growth and achieving inclusive and sustainable development

Despite a slowdown in economic activity from the global recession 2008-2009, Asia and the Pacific has demonstrated relative resilience as a region in comparison to other parts of the world. However, this economic resilience masks rising social inequities, slow job creation, persistent employment informality, insufficient development of domestic demand and regional infrastructure, as well as high resource-intensity of the region’s production structure.

The solution to improving the quality of growth in the region lies in boosting domestic demand through government policies that are directed towards strengthening social and environmental pillars of sustainable development. In the social sphere, making development more inclusive will spur consumption by the majority of the population in many developing economies, including the poorest and most vulnerable members of society. In the environmental sphere, the current failure of countries to tackle degradation in their natural environment and to reduce high-resource intensity of their production structure is impeding the ability of their economies to perform at full potential. Issues that have a direct bearing on the quality of economic growth include deforestation, damage to water and energy sources, and air pollution.

Governments need to take the leading role in tackling the problems of falling demand and long-term structural impediments by synergizing action on economic, social and environmental fronts to address critical risks through supportive fiscal and monetary policies (see box 1.6). In the short-term, governments should engage in stimulatory policies to provide a floor to the impact of constrained global growth prospects. Most countries in the region have both the fiscal and monetary space to undertake such policies without adverse macroeconomic consequences. This endeavour, however, is challenging in the face of instabilities associated with capital flows, insufficient financial regulation and inadequate access to direct
Implementing policies that facilitate investment in natural capital and allow the economic benefits and costs of disaster risk mitigation to be reflected in the economy is an important long-term strategy for economic system change. Policies that “recalibrate” prices of natural capital so that social and environmental costs and economic and social benefits are internalized in the economy are critical for changing growth paths. This requires policy reform, sustainable consumption and lifestyles, and most importantly a focus on changing price signals. This goes beyond advocating more taxes, but focusing policy design on achieving a double dividend for both the economy and environment through revenue-neutral environmental tax reform.

The simple, but powerful concept of revenue neutrality promotes a shift in the tax base from income to resource consumption. By doing this, environmental tax reform can change market price signals without damaging the economy. Proper policy design can also avoid harming the poor. This has been practiced by some European countries, such as Germany, Sweden, Denmark, and the United Kingdom of Great Britain and Northern Ireland Environmental fees and taxes are being explored by governments of the region, including those of China, Indonesia, Thailand, Vanuatu and Viet Nam. They stand to form an important basis for implementing a more strategic approach geared to synergizing the three pillars of sustainable development.

A study commissioned by ESCAP further illustrates the potential for a double dividend in developing countries in the region. A modelling exercise explored the impacts of introducing a tax of $10 per ton of CO2 at the same time as reducing corporate tax in seven countries – Cambodia, China, India, Japan, Malaysia, the Republic of Korea and Thailand. The result was that there could be an increase in GDP, depending on the scenario and countries. For Thailand, the figure was 1.53% higher GDP growth and up to 6.72% lower carbon reduction vis-à-vis a business-as-usual scenario.

In locations where food price trends are increasingly coupled to energy price trends, due to the increasing energy intensity of agricultural production, a critical intervention is required in order to energize rural economies through a renewed emphasis on sustainable agriculture and eco-efficient agricultural models instead of those that are resource-intensive. This will involve applying sustainable production methods, increasing the productivity of basic agricultural production and improving the value-added content of agricultural products by moving up the value chain. The relative neglect of government spending devoted to agricultural research and development in recent decades should be reversed to harness indigenous knowledge to preserve agricultural diversity and boost competitiveness based on expanding opportunities presented by global markets which are increasingly sensitive to the health impacts of an increasingly industrialized food industry.

Following years of easy credit and overinvestment before the crisis, the world now faces overcapacity in most profitable economic sectors, and hence, an understandable reluctance for the private sector to invest in green technology. In this situation, only well-coordinated cross-border public investments can fund the needed green public goods, and induce complementary private investments through public-private partnerships. Besides contributing to a sustained economic recovery, such investments would also enhance climate change mitigation while advancing the region’s developmental aspirations and ensuring food security.
taxation revenues. Therefore, these policies need to be supplemented with capital flows management measures and trade, investment and other structural policies as noted at various parts in this chapter.

Governments need to take the leading role in tackling the problems of falling demand and long-term structural impediments

Just as critical as the quantum of such policies is the judicious design of the policies to ensure maximum impact. Fiscal and monetary stimulus should be directed towards enhancing productive investments in infrastructure, in particular in rural areas, labour-intensive SMEs and agriculture as well in green technologies. As argued in the ESCAP 2009 Economic and Social Survey of Asia and the Pacific (ESCAP, 2009a), the support measures should be designed in such a way that they also address long-term structural impediments. Critical areas from which higher public investment can attain both short-term and long-term objectives are employment guarantee schemes linked to active labour market programmes (ALMP), social protection, including income support for elderly and persons with disabilities, education, health and renewable energy for energy security. A government employment guarantee, linked to ALMP, is an important instrument to cushion the business cycle and preserve skill sets of the workforce. Besides being an automatic stabilizer, it can preserve skilled labour during the time of economic slowdown to be available when economic conditions improve. Greater investment in social protection is needed to reduce economic insecurity and vulnerability and thereby foster inclusive and balanced growth by sustaining domestic demand, particularly during an economic downturn.

Chapter IV contains a detailed analysis of a policy package involving these elements. The analysis shows that such policies are fiscally sustainable and would not lead to accelerating inflation. The chapter includes a discussion on some key macroeconomic policy dilemmas that arise in efforts to support growth in the short to medium-term and achieve inclusive and sustainable development in the long-run.

**Debt, inflation and fiscal sustainability**

Higher levels of public debt and inflation in a number of countries, especially in South Asia, are often viewed as factors restricting expansionary fiscal and monetary policies. Yet, this should not necessarily be the case. To begin with, policymakers need to consider what could happen to their respective economies’ debt levels or debt-GDP ratio if growth falters, especially if fiscal consolidation is attempted when growth is slowing, in the light of the experience of crisis-hit European countries. It is worth referring to the recent observation by the IMF that “there is no single threshold for debt ratios that can delineate the “bad” from the “good” (IMF, 2012c).

As argued in chapter III, there is no intrinsic harm in having relatively high levels of debt when it supports spending on productive uses. It can be seen from studies that the negative relationship between debt and GDP is small. On the other hand, the positive relationship between debt-financed spending and other variables such as years of schooling is relatively high (IMF, 2010). Therefore the growth-inhibiting effects of a given percentage increase in debt-to-GDP ratio can be easily overcome by a given percentage increase in growth-promoting variables achieved through public spending in areas such as education, health, physical infrastructure and energy efficiency.

This highlights the key point that policymakers should be concerned with the composition of debt-financed spending rather than the aggregate level of such debt (Chowdhury and Islam, 2010). Spending that is directed to productive uses can increase growth along with an increase in debt and therefore eventually have a neutral or positive impact on debt-to-GDP ratios. In sum, policymakers should be aware of the developmental role of fiscal policy and not remain excessively focused on its stabilization role, a key message of forward-looking macroeconomics.
Policymakers should be concerned with the composition of debt-financed spending rather than the aggregate level of such debt

It is also important to examine whether higher debt-GDP ratios are a result of past failure to collect enough revenues despite decades of higher growth and/or due to unproductive expenditure. If this is the case, then policymakers need to reprioritize public programmes and improve efficiency of public expenditure as well as take steps to improve revenue collection by broadening the tax base and enhancing the efficiency of tax administration. If tax revenues are earmarked for socially desirable expenditure, there will be incentives for tax payments. In this context, the recent experience of the “Tax for Development” campaign implemented in Bangladesh is very encouraging; the tax-to-GDP ratio in Bangladesh has risen from approximately 9% to approximately 13%.

Similarly, it is not clear that monetary policies should not be eased even in a climate of relatively high inflation if such policy easing is supportive of growth. If such easing is undertaken in an environment in which other structural barriers that hamper the returns to investment, such as energy shortages, are removed, the cheaper price of credit can spur the activities of the private sector. Reducing the cost of credit by expansionary monetary policy will not necessarily lead to increased inflation if it is ensured that credits are directed through regulatory measures to productive investments, especially to agriculture and not to speculative investments in assets.

Indeed, the relationship of inflation with growth is found to be non-linear in numerous large cross-country studies (Chowdhury and Islam, 2012b). It becomes negative only beyond moderate rates of inflation, ranging from 13% to 17%. Historical evidence based on the experiences of Indonesia and the Republic of Korea during their rapid transformation also reveals that such moderate inflation rates do not harm growth; nor do they dampen poverty reduction.

The above observation is critical for forward-looking macroeconomics for monetary policy to balance stabilization and developmental needs. It is pertinent to point out here that the IMFs Article of Agreement acknowledges the developmental role of monetary policy. For example, the preamble of Article IV (i) states, “each member shall: endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances” (IMF, 2011).

Regional cooperation for addressing infrastructure deficits

A key underlying need in order to increase the inclusive and sustainable nature of growth is to address the yawning infrastructure gaps for many economies in the region, which, according to an ADB study in 2009, are estimated to be in the order of $800 billion per annum.19 Recent analysis by the World Bank estimates the annual need for infrastructure in East Asia and the Pacific at $407 billion, with the current spending on infrastructure far below the requirement, standing at around $200 billion (Brereton-Fukai, 2013). In addition, Asia and the Pacific needs to spend approximately $290 billion on specific regional infrastructure projects in transport and energy that are in the pipeline. If the required investment toward pan-regional connectivity is made in transport, communications, and energy infrastructure during the period 2010–2020, the real income of developing Asia during that period and beyond could reach $13 trillion (ADB and ADBI, 2009). The infrastructure financing gap in the region has recently become a concern for the Group of Twenty (G20), with countries pledging to give the issue attention during the grouping’s deliberations during 2013 (Brereton-Fukai, 2013).
Interregional infrastructure connections offer a powerful avenue to pool resources as well as boost trade

The need to improve infrastructure goes beyond national boundaries as interregional connections offer a powerful avenue to pool resources as well as boost trade. The region consists of both resource-rich and resource-poor countries which can be brought together through cross-country infrastructure in a host of areas. The challenge is to bridge the enormous infrastructure needs of the region with sufficient sources of investment. In addition to lending by multilateral development banks, such as ADB and bilateral development banks, a number of subregional initiatives are ongoing such as the SAARC Development Fund and the ASEAN Infrastructure Fund. As ESCAP has proposed (ESCAP, 2012c), such existing forms of investment could be complemented with a new large-scale regional lending facility for infrastructure. This facility could help coordinate other sources of lending, such as by multilateral and bilateral development agencies and private financial institutions. Its backing for infrastructure projects could also signal opportunities to private investors. As a regional body, the facility could also be in a position to keep track of intraregional spillovers and finance economically significant cross-border projects. Another possible function of the facility could be to extend advisory services and technical assistance. Its capital base could be funded by contributions made by central banks and funds raised through issuing bonds. The ESCAP secretariat is currently engaged in elaborating elements of a regional financial architecture for supporting infrastructure investment.

Endnotes

1 The most influential view is that fiscal austerity now is necessary because it will instill “market confidence” that lies at the core of private sector spending decisions. Nobel Laureate Paul Krugman has often lamented this as an undue faith in the “confidence fairy” to spur growth. The advocates of the “market confidence” thesis overlook the fact that rating agencies typically include growth variables in their assessment of sovereign risk analysis. More importantly, studies have shown that the impact of a growth contraction on measures of sovereign risks is higher than the impact of debts and deficits on such risks. Hence, when fiscal consolidation leads to growth contractions they reduce rather than raise market confidence. See Cottarelli and Jaramillo (2012). Also, see Krugman (2012).

2 Bagaria, Holland and van Reenen (2012). Also see, Chowdhury and Islam (2012a).

3 A credit event for sovereign debt could occur as a result of either failure to pay a coupon or principal on a bond or loan; a distressed debt restructuring, meaning a restructuring that changes the terms of a debt obligation to the disadvantage of investors; and debt repudiation, meaning the announcement by an authorized official of the intention to suspend payments.

4 Borrowing costs are at a historic low for advanced countries, such as the United Kingdom, the United States and Japan, despite high public debt. As pointed out by Krugman (2012), this probably reflects the fact that there is a flight to safe assets issued by advanced country governments that “still own their currency”.

5 ILO estimates from official national sources.


8 Subregions as defined by ILO are as follows: South Asia refers to Afghanistan; Bangladesh; Bhutan; India; Maldives; Nepal; Pakistan; and Sri Lanka; South-East Asia and the Pacific refers to Brunei Darussalam; Cambodia; East Timor; Indonesia; the Lao People’s Democratic Republic; Fiji; Malaysia; Myanmar; the Philippines; Singapore; Thailand; Viet Nam; Fiji; Papua New Guinea; and Solomon Islands; and East Asia refers to, China; Democratic People’s Republic of Korea; Mongolia; Republic of Korea; China, Hong Kong; Macau, China, and Taiwan Province of China.

9 ILO (2011b), table R8. Developed economies include: Australia, Canada, Iceland, Israel, Japan, New Zealand, Norway, Switzerland, the United States and the economies of the European Union.

10 Such an episode is defined by the ratio of net private capital inflows to GDP in the year after the episode ends being more than 5% lower than that of the episode.
11 Analysis in the following section is drawn from ESCAP, Asia-Pacific Trade and Investment Report (2012).

12 Under this type of transaction, domestic value-added is very low. The imported inputs and the finished outputs remain property of the foreign supplier.

13 ASEAN+3 comprises the 10 ASEAN countries plus China, Japan and the Republic of Korea; ASEAN+6 comprises ASEAN+3 plus Australia, India and New Zealand.

14 When examining intraregional FDI flows, data availability becomes a limiting factor. In particular, data on South-South investment flows are very limited. Thus, for this part, the analysis is also based chiefly on greenfield investment flows. The analysis of intraregional flows in ASEAN relies on data for total FDI flows.

15 Dutch disease is a phenomenon where a rapid expansion of the natural resources sector leads to currency appreciation, thereby reducing the competitiveness of other industries. See, for example, Moran (2011).

16 Reference is the direct use by the economy (domestic material consumption) of four categories of resources (biomass, fossil fuels, metal ores and industrial minerals, and construction minerals) and 11 subcategories.

17 Food and Agriculture Organisation (2011). It should be noted that the FAO-defined Asia-Pacific region is different from the ESCAP-defined region.

18 See, for example, Ostry and others (2010b).

19 ADB and ADBI (2009). This is in line with an earlier estimate by ESCAP of $600 billion per annum (ESCAP, 2006).
The growth momentum of the developing economies of Asia and the Pacific slowed to 5.6% in 2012 compared with 7% in 2011. However, this region is vast and very diverse, and aggregate figures mask the diversity in performance and the challenges being faced at the subregional and country levels. Therefore, this chapter affords a more disaggregated analysis of macroeconomic performance and policy challenges at the subregional level, with some details at the country level. In the Survey, the Asia-Pacific region is divided into five geographic subregions: East and North-East Asia; North and Central Asia; the Pacific; South and South-West Asia; and South-East Asia. An overview of macroeconomic performance and policy challenges in all these subregions is furnished below, followed by more detailed discussions on each subregion.
Diversity in performance across sub-regions

The East and North-East Asian subregion comprises China; the Democratic People's Republic of Korea; Hong Kong, China; Japan; Macao, China; Mongolia; and the Republic of Korea. As a result of the continued economic slowdown in the United States and Europe, all the economies in the East and North-East Asian subregion, except Japan, registered lower growth rates in 2012. However, GDP growth in China was still among the highest in the world. The situation was different in Japan. The country first recovered during the early part of 2012 as a result of the reconstruction activities that were launched in the wake of the massive earthquake and tsunami that occurred in March 2011, but then Japan fell into recession. However, it achieved positive growth for the year as a whole. Inflationary pressures abated in most economies in the subregion, enabling monetary and fiscal policies to function in support of economic activity. On the external side, most of these economies continued to achieve current account surpluses, except Mongolia, which had a large current account deficit. Foreign direct investment inflows weakened in 2012 as global uncertainty built up. Contingent upon a mild global recovery, the outlook for the subregion in 2013 is generally positive. Policymakers are conscious of the need to adapt the broad normative and institutional environment in a way that is conducive to more inclusive and sustainable development. In these circumstances it is important to maintain the focus on social policy reform and the transition to a greener economy.

The North and Central Asian subregion covers Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, the Russian Federation, Tajikistan, Turkmenistan and Uzbekistan. Although economic performance in the subregion remained robust at the beginning of 2012, several of these economies began to feel the impact of a deteriorating external economic environment in the latter part of the year. In addition, severe weather conditions in some countries, which resulted in a poor harvest, contributed to some slowdown in the economic growth of the subregion in 2012. A number of the economies in the subregion are net energy exporters; with oil prices expected to remain relatively firm, growth rates are projected to remain more or less the same in 2013. Consumer price inflation eased in 2012, mainly due to the decline in global food and fuel prices. Budget balances deteriorated in most of the economies due to increased public spending. On the external side, current account surpluses of the economies that are net energy exporters contracted, and the current account deficit of the net energy importers widened. Owing to slower economic growth in Kazakhstan and the Russian Federation, the remittances of overseas workers from these countries to net energy-importing countries in the subregion started slowing. Economies in the subregion continue to face serious challenges owing to their reliance on commodity exports, making them highly exposed to the external economic environment. Further diversification of these economies will always remain a challenge. As most of these countries are landlocked, issues of trade and transit are highly relevant for them. Further development of transport infrastructure will continue to remain a high priority in these countries.

The Pacific subregion includes the Cook Islands, Fiji, Kiribati, the Marshall Islands, the Federated States of Micronesia, Nauru, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu. Australia and New Zealand are also part of this subregion. The Pacific island developing economies face unique challenges, including small population size, poor resource base (except in a few exceptional cases), remoteness from their more developed trading partners, frequent natural disasters and adverse impacts from global climate change. These constraints make it difficult for them to achieve high economic growth rates on a sustained basis. The growth of these economies generally slowed in 2012. Papua New Guinea, the resource-rich and largest economy among the developing island States in the subregion, continued to achieve high levels of economic growth, but at a slightly lower rate than in 2011. Deceleration in growth of these economies is expected to continue in 2013. With slower growth, inflationary pressures also subsided.
in 2012, with Fiji and Papua New Guinea recording declines in inflation. Budgetary deficits were generally not very high in 2012 despite some increases in the larger economies. With regard to the external sector, these economies face high and rising current account deficits, reflecting largely poor performance of their merchandise exports rather than high levels of imports. Some of these economies are highly dependent on the remittances of overseas workers, which slowed due to the weakening global economic environment.

Australia and New Zealand, the two developed economies in the subregion, suffered from natural disasters: Australia, from floods and New Zealand, from earthquakes. Both economies are recovering from these natural disasters. Reconstruction activities contributed to improved growth performance of these economies in 2012, and at the same time inflation rates fell. The strong Australian dollar is weighing on the prospects for the Australian economy; however, the overall performance of the country in 2013 will depend on the mining sector’s continued boom.

The South and South-West Asian subregion comprises Afghanistan, Bangladesh, Bhutan, India, the Islamic Republic of Iran, Maldives, Nepal, Pakistan, Sri Lanka and Turkey. The global slowdown is having adverse impacts on exports and consequently on economic growth in most economies of the subregion. Moreover, there has been slower growth as well in domestic demand, particularly investment. A moderate pickup in growth is expected in 2013. Inflation is remaining stubbornly high despite the slowing of economies and is a matter of serious concern, especially for a large number of people living in poverty in these countries. Large fiscal deficits are rising further in some countries. On the external side, current account deficits are rising and contributing to depreciation of domestic currencies. Large remittances from overseas workers continue to grow in some of these countries. The global financial and economic crises have highlighted policy lessons in terms of rebalancing economies in favour of greater domestic and regional demand, and for a cautious approach to financial liberalization. Other policy priorities include pursuing reforms to regain policy space to increase social expenditure and close infrastructure gaps. Finally, South and South-West Asia, which is home to the highest number of poor and malnourished people compared with all other subregions combined, needs to maximize its growth potential and increase productive employment opportunities by reviving industries and expanding rural non-farm activities, thereby further reducing poverty and hunger.

The South-East Asian subregion covers Brunei Darussalam, Cambodia, Indonesia, the Lao People’s Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Timor-Leste and Viet Nam. The subregion as a whole achieved higher levels of economic growth in 2012 than in 2011, despite weakening external demand. Private consumption was strong and supported by policy measures, such as minimum wage increases, while investment benefited from increased public infrastructure outlays. A strong rebound was also seen in Thailand following the floods of 2011. With inflation largely stable across the subregion, monetary policy was accommodative and credit growth high, but macroprudential measures were used to reign in potential asset bubbles. While exports showed further signs of weakness in the second half of the year, foreign direct investment and remittance inflows were largely unaffected. Net portfolio inflows remained volatile but in a number of countries, including Malaysia, the Philippines and Thailand, those inflows trended upward. The near-term economic outlook is favourable despite strong headwinds. Productive jobs, social protection and clean energy are among the key challenges for achieving inclusive and sustainable growth.

**EAST AND NORTH-EAST ASIA**

**Growth slows as the global economy weakens again**

Most of the economies in the East and North-East Asian subregion performed broadly well in the first
half of 2012, but growth slowed during the second half of the year as Europe struggled to solve its sovereign debt crisis and the economic recovery in the United States remained anaemic. GDP growth in the subregion as a whole improved to 4.1% in 2012 compared with 3.5% in 2011 (see table 2.1). However, this improvement in growth was due to economic recovery in Japan after the 2011 earthquake and tsunami. Excluding Japan, average GDP growth in the subregion decelerated to 6.4% in 2012 from 8% in 2011, reflecting the slowdown of all the economies in the subregion.

Most of these economies are highly export-oriented. The share of the agricultural sector in GDP has gone down with the increase in the shares of the industrial and services sectors in the economy over the years. In 2011, the agricultural sector accounted for about 10% of GDP in China and about 15% in Mongolia. The share of the agricultural sector was much lower in other economies. The share of the industrial sector in GDP was more than 40% in China and somewhat lower in Mongolia and the Republic of Korea. The services sector gained in all the economies and dominated in some, including in Hong Kong, China; and Macao, China.

The economy of China grew by 9.2% in 2011 but growth fell to 7.8% in 2012, with the rate of GDP growth slowing for 7 straight quarters and missing the Government’s target in the period July-September 2012, for the first time since the depths of the global financial crisis. At the end of the year, the activity indicators of China were generally stronger than expected, providing further evidence of an economic rebound in the last quarter. On the demand side, growth was supported by domestic consumption and capital formation, partly reflecting the positive effects of policy easing (cuts in interest rate and reserve requirements) that had been put into place early in the year. Investment in real estate development grew in 2012 but at a rate lower than in the previous year. While residential property prices continue to rise, other housing market data point to signs that China’s real estate market is stabilizing, even as tightening measures remain in place. As the year progressed, inventories for major natural resources, such as coal and copper, built up at record levels. In the second half of the year, net exports offset some weakening in overall investment.

The economy of Hong Kong, China experienced tepid growth, with real GDP growth for the full year abating to 1.4% in 2012, compared with 5% growth in 2011. Merchandise exports remained sluggish amid severe external headwinds, while the domestic sector kept some momentum, propped up by private consumption expenditures, due to a tight labour market.

<table>
<thead>
<tr>
<th>Country</th>
<th>Real GDP growth</th>
<th>Inflationa</th>
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<tbody>
<tr>
<td></td>
<td>2011</td>
<td>2012b</td>
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<tr>
<td>East and North-East Asia</td>
<td>3.5</td>
<td>4.1</td>
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<td>East and North-East Asia (excluding Japan)</td>
<td>8.0</td>
<td>6.4</td>
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<tr>
<td>China</td>
<td>9.2</td>
<td>7.8</td>
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<td>Democratic People’s Republic of Korea</td>
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<tr>
<td>Hong Kong, China</td>
<td>5.0</td>
<td>1.4</td>
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<tr>
<td>Japan</td>
<td>-0.6</td>
<td>2.0</td>
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<tr>
<td>Macao, China</td>
<td>20.0</td>
<td>9.0</td>
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<tr>
<td>Mongolia</td>
<td>17.3</td>
<td>12.3</td>
</tr>
<tr>
<td>Republic of Korea</td>
<td>3.6</td>
<td>2.0</td>
</tr>
</tbody>
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a Changes in the consumer price index.
b Estimates.
c Forecasts (as of 30 March 2013).
d GDP figures at market prices in United States dollars in 2011 (at 2000 prices) are used as weights to calculate the subregional growth rates.
market, strong construction activity and vigorous public sector infrastructure works. Gambling, which attracted 28 million visitors in 2011 and accounts for more than 40% of GDP, is one of the factors behind the rapidly growing economy of Macao, China. GDP growth was still strong at 9% in 2012 but much lower than 20% in 2011. There are concerns, however, that this aspect has made the economy excessively vulnerable to external shocks and that more efforts are required to diversify the domestic economy and improve social services.

**Growth slows in China but still among the highest in the region**

The Democratic People’s Republic of Korea does not release official economic data. However, available information suggests that the country’s economy has contracted during 4 of the last 6 years, and some 16 million of the country’s 24 million people suffer from chronic food insecurity and malnutrition (United Nations, 2012b).

In Japan, following a contraction of the economy by 0.6% in 2011, GDP increased by 2% in 2012 as growth picked up strongly in the first quarter, driven by government reconstruction expenditures related to the earthquake and tsunami of March 2011, and the export sector’s recovery from the effects of severe flooding in Thailand in late 2011. Japan, however, then entered into a technical recession of two consecutive quarters of contraction, underscoring the difficulties facing the economy as a result of weak exports and softening domestic demand. Capital spending decelerated and net exports made a negative contribution to growth in the second half, when Sino-Japanese tensions also took a toll via different channels, including declines in export volume, in the sales of China-based subsidiaries of Japanese firms and in the number of tourists from China visiting Japan.

Mongolia is a commodity-based economy and strong mining activities helped the country to achieve double-digit growth at 12.3% in 2012, which was lower than the rate of 17.3% in 2011. Thanks to development of the mining sector financed by foreign direct investment (FDI), living standards have been improving and poverty declining significantly in the country. Moreover, the economy’s prospects are promising as copper and coal production are set to expand considerably over the next few years. However, uncertainty regarding the “rules of the game” is halting some major FDI projects.

In the Republic of Korea, GDP growth slowed to 2% in 2012 from 3.6% in the previous year. A weaker global economic environment and gloomier consumer sentiment served to offset investment in the information technology sector and the frontloading of the budget to slow GDP growth in the Republic of Korea. The pickup at the beginning of the year proved to be short-lived, with domestic consumption, exports and fixed investment weakening sharply since the second quarter of 2012. Economic activity was basically flat in the third and fourth quarters, despite the one-off momentum provided by such special circumstances as the release of new telecommunications equipment.

**Inflation slows but volatile food and fuel prices continue to affect households**

Inflation slowed in all economies of the subregion in 2012, except in Mongolia (see figure 2.1). On the other hand, consumer prices became more stable in Japan. Inflation, which was a major policy concern in China and the Republic of Korea over 2011, has been on a declining trend. Slowing growth, stable commodity prices and cooling property markets combined to drive inflation within reach of policy objectives. In China, consumer price inflation fell to an average of 2.7% in 2012, down from the previous year’s inflation rate of 5.4%. In the Republic of Korea, growth in consumer prices dropped to 1.2% in August – a 12-year low – before rising slightly to 1.5% in December, remaining below the bottom of policymakers’ 2-4% target range. For the year as a whole, inflation fell to 2.2% in 2012 from 4% in 2011.
In Japan, consumer prices rose during the first half of 2012. However, deflationary situation re-emerged in the remainder of the year. For the year as a whole, consumer price index remained unchanged, meaning zero inflation in 2012 as compared to 0.3% deflation in 2011. The Bank of Japan boosted asset purchases five times in 2012 and introduced a new bank lending facility to provide banks with collateralized loans at an overnight call rate of 0.1%, while also announcing no change in its policy rate of 0-0.1%. Early 2013, in a departure from previous practice, the Bank of Japan decided to double the inflation target to 2% for fiscal year 2013/14.

Mongolia was a clear outlier, with inflation accelerating to 16% in April 2012, before receding to 14.4% in November 2012, still well above the Bank of Mongolia's 10% target. Inflation for the year as a whole was 14.3%, much higher than the 9.2% recorded in 2011. The roots of high inflation are to be found in high food (notably meat) prices and an expansionary fiscal policy which has led to demand-side pressures in an already overheating economy.

Monetary policy stance supportive of growth

In responding to concerns that growth may be slowing too quickly, Governments in countries in the subregion activated appropriate policy levers. The burden of the countercyclical response was split between fiscal and monetary policy. Policymakers’ tasks are complicated by actions elsewhere: loose monetary policies may translate into higher consumer prices, whereas quantitative easing in the United States may cause inflows of speculative funds into the subregion, which may cause nominal appreciation of the currencies of economies in the subregion. In December, the Government of the Republic of Korea acted proactively to ward off possible volatility and cut the forward position limit for foreign banks from 200% to 150% of capital, and from 40% to 30% for domestic banks.

The ongoing shifts in the balance of risks from inflation made it relatively easy to introduce adjustments on the margin to the country’s monetary policy stance. In June 2012, China cut borrowing costs for the...
first time since 2008, as the one-year lending rate declined by a quarter of a percentage point to 6.3%. A month later, the rate was cut further to 6%. The People's Bank of China also reduced the reserve requirement ratio twice and reaffirmed its commitment to widen the use of the yuan currency in cross-border trade and investment and to gradually push ahead with capital account convertibility.

In June 2012, China cut borrowing costs for the first time since 2008.

Japan's monetary policy was by far the most aggressive, with the Government pursuing a dual goal of beating deflation and weakening the strong yen through monetary easing. In the meantime, the Bank of Japan reaffirmed its commitment to encourage the uncollateralized overnight call rate to remain in a range from 0 to 0.1%. The Bank of Korea lowered the base rate by 50 basis points to 2.75% in two steps, in July and October 2012. In Mongolia, on the other hand, the policy rate on the central bank's bills was increased twice by 50 points, in March and April 2012, to 13.75%. The draft monetary policy for 2013 that Mongolbank introduced in October 2012 is aimed at keeping inflation below 8% by the end of 2013. The Monetary Policy Council was also established to ensure financial stability, with a total of 12 members, 4 of whom are from outside Mongolbank. For the first time since late 2009, the Hong Kong Monetary Authority stepped into the market to defend the currency's peg to the United States dollar, as the Hong Kong dollar touched the stronger end of the 7.75-7.85 trading band.

Adequate fiscal space in most economies provides the flexibility to consider stimulus.

Fiscal policy is also being used to revitalize subregional economies. Since mid-April 2012, through different policy announcements, the Government of China implemented a series of supportive measures to stabilize the country's growth momentum. However, the stimulus was smaller in size, had a shorter timespan, put less emphasis on credit and relied less on local government funding than that of 2009. As was the case with the post-Lehman Brothers stimulus package, the Chinese package relied heavily on infrastructure spending. A difference this time around was the greater focus of the new package on energy-saving and innovation. In addition to expansionary fiscal and monetary policies, the approach has also entailed forms of regulatory forbearance to encourage bank lending, although the new schedule is still fully consistent with the implementation of the capital adequacy reforms of the Basel Committee on Banking Supervision.

In Japan, the quest to pull the country out of its deflationary trend continued. In July 2012, the Government released the draft of its “Comprehensive Strategy for the Rebirth of Japan”, a medium- to long-term growth strategy that would be in effect through fiscal year 2020. Under the strategy, 38 policies in 11 fields are outlined that are aimed at creating a new market centred on the environment, which would be worth more than ¥50 trillion and would create 1.4 million jobs. The Cabinet also compiled a report on measures to stimulate demand by retrofitting buildings and renovating dilapidated infrastructure, including by promoting private finance initiatives. In August 2012, the Diet, Japan’s legislature, passed long-debated social security and tax reform legislation, including an agreement to double the consumption tax rate to 10% by 2015. Two supplementary stimulus packages of limited size, earmarked for health-care, agricultural and public works projects, were announced in the fourth quarter of 2012. They will be funded by the fiscal reserve fund, without incurring any new debt issuance. Subsequently in January 2013, the Government announced an additional and sizeable stimulus package to lift the economy out of another bout of recession. The new stimulus package will be allocated towards post-disaster reconstruction and social security, as well as measures to promote private investment and revitalize industries.
The Republic of Korea announced in June 2012 stimulus spending of 8.5 trillion won ($7.4 billion), equivalent to about 0.6% of GDP, which added a quarter of a percentage point to GDP in 2012. The measures, including assistance for small businesses and low-income earners, used money from the existing budget. The overall fiscal stance remains conservative, with plans to balance the budget and gradually achieve a surplus from 2014. Efforts are being made to restructure inefficient and unproductive business projects for the purpose of saving financial resources and allocating more resources for facility investment, job creation and investment in green growth, in order to improve the economy’s potential for growth. The Government frontloaded its 2013 budget by assigning 60% of planned expenditures in the first half of the year, with most of the money geared towards infrastructure projects and other job-creating endeavours. Government spending on social protection is also expected to rise significantly starting in 2013, in line with the new President’s commitment to make economic growth more inclusive.

In Mongolia, fiscal policy was also expansionary in order to build physical infrastructure and strengthen the provision of social services (see figure 2.2). This has resulted in higher inflation and a higher current account deficit. However, government spending is expected to move in a more countercyclical manner after the Fiscal Stability Law, passed in 2012, takes effect in 2013.

**Current account remains in surplus**

Economies in East and North-East Asia enjoyed a current account surplus in 2012 (see figure 2.3). Mongolia is the only exception; it has a large current account deficit due to its imports of machinery for the mining sector and strong domestic demand because of the economy’s double-digit growth. In 2012, the current account as a share of GDP remained positive at about 2.6% in China, 1% in Japan and 3.9% in the Republic of Korea. The rebalancing in China is noteworthy as it compares with a current account surplus of more than 10% of GDP in 2007, that is, before the outbreak of the global financial crisis. In Japan, the seasonally adjusted current account was temporary in deficit in September 2012 – for the first time in more than 30 years. On the other hand, the current account balance remained in surplus for 10 consecutive months for the Republic of Korea, which last posted a deficit in January 2012. In Mongolia, as imports of consumption goods rose rapidly as a result of domestic demand pressures, the current account deficit remained very high (in double digits).
Net exports remain supportive but intra-regional trade growth weakens

The East and North-East Asian subregion currently accounts for 24% of real merchandise trade globally. In fact, it was the main growth driver of global trade in 2011. Its trade surplus vis-à-vis the rest of the world rose from $99 billion in 2011 to $102.5 billion in 2012. In China and the Republic of Korea, exports accelerated more rapidly than imports, while the reverse held true for Hong Kong, China; and Japan. The contribution of net exports to growth remained supportive, except in Japan which saw a record trade shortfall as purchases of liquefied natural gas and crude oil rose. In the Republic of Korea the trade balance briefly fell into deficit early in 2012 as shipping exports slowed and semiconductor prices kept declining, but then they recovered.

Trade among the subregion’s three main economies (China, Japan and the Republic of Korea) fell slightly in value terms from that of the previous year. As a percentage of total exports, trade within the subregion declined from 20% in the first half of 2011 to 18.8% in the corresponding period in 2012; the reduced salience of intra-area exports was particularly pronounced for Japan. Exports to China, Japan’s top export market, fell by 6.1% in the first half of the year, marking the first drop in three consecutive first-half-year periods since 2009; shipments dropped further by 12% in October compared with the same month in the previous year after a 15% fall in September, reflecting the rise in antagonism over disputed islands. Sales to economies in the subregion were equally significant in Mongolia, at more than 94% of the total exports of the country.

The balance of payments softened under these conditions. The current account balance in Japan recorded the smallest surplus in the second quarter, on a seasonally adjusted basis, since 1996 when time-consistent data were first collected. These developments in turn dampened foreign exchange accumulation, as well as the pace of nominal and real exchange rate appreciation.

By the end of 2012, total official reserves of economies in the subregion grew by less than 1% to $5,118 billion compared with reserves held at the end of 2011, whereas they had increased by 3.1% in the second half of 2011.

Currencies of countries in the subregion appreciate slightly against the dollar

The turmoil in Europe led to the flight of capital to safety and had impacts on the subregion’s financial
markets. Since the end of 2011, equity prices have risen in Hong Kong, China; Seoul; and Tokyo, while they declined in Shanghai. Yields on 10-year government bonds have fallen to nearly historic lows. The authorities in China let the currency appreciate. In addition, they moved towards a more flexible exchange rate regime and, since the third quarter of 2011, a substantial reduction in the level of official intervention in exchange markets, as well as a series of steps to liberalize controls on capital movements. All the major currencies in the subregion appreciated slightly against the United States dollar in 2012, with the exception of Japan’s currency which started to drop against the dollar in response to the rigorous expansionary monetary stance taken by the Government of Japan.

Foreign direct investment contracts amid weakening global investment sentiment

FDI inflows weakened in 2012 as global uncertainty built up. Inflows of FDI to China contracted by 3.7% in 2012 to $111.7 billion; however, China became the world’s largest recipient country of FDI (UNCTAD, 2012). Inflows to Hong Kong, China declined much more significantly. Japan continued recording net divestment (negative net inbound flows). On the other hand, inward FDI in the Republic of Korea reached record highs in the first nine months of 2012 ($11.2 billion, up by 48% from a year earlier). Performance in the third quarter was the best on a quarterly basis since 2002. For the whole year, inward FDI increased by 19%.

The relative importance of intra-subregional flows of FDI increased, as FDI outflows from China and Japan to the subregion increased

In sharp contrast, outward FDI flows from China expanded by 28.6% in 2012. The acquisition by the China National Offshore Oil Corporation of Nexen Inc., a Canadian oil sands and shale gas producer, for $15.1 billion has been the largest Chinese overseas deal ever. Japanese deals for companies overseas got bigger and bolder, with multibillion dollar purchases in telecommunications (Sprint Nextel Corporation in the United States) and advertising (Aegis Group PLC in the United Kingdom) signalling a shift to service-based industries. Against this background, the relative importance of intra-subregional flows of FDI increased. Investment in the Republic of Korea from China increased significantly. Japanese firms grappling with a strong yen over a longer period and the disruption caused by the 2011 earthquake and tsunami were particularly active in building manufacturing capacity in China and the Republic of Korea, notably in parts and materials. Tencent, Inc., a Chinese Internet company, paid $64 million for a 13.8% stake in Kakao Inc., operator of the Republic of Korea’s most popular mobile messenger, Kakao Talk. That stake has turned Tencent into Kakao’s second largest shareholder.

Future outlook and policy challenges

As the global economy makes a hesitant and uneven recovery in 2013, growth is expected to pick up somewhat in East and North-East Asia, with increasingly supportive monetary and fiscal policies offsetting the drag exerted by external demand that is below par. China is expected to grow by 8% in 2013, better than the official target of 7.5%. GDP growth is also expected to gather momentum in the Republic of Korea and is projected to grow by 2.3%. Growth performance is also projected to improve in Hong Kong, China; and Macao, China. Economic activity in Japan, is expected to pick up, and growth is projected to increase by 2.5%. In Mongolia, strong mining activity is expected to push the GDP growth rate up to 15.5% in 2013.

There are considerable and interrelated downside risks for the subregion. Externally, a further slowing of demand from the euro zone and the United States can quickly reverberate through the subregion’s production and trade networks. China (including Hong Kong, China) occupies an increasingly central position in such networks, but Japan and the Republic of Korea are also closely connected as producers of high-tech tangible and intangible inputs, while Mongolia is an increasingly relevant supplier of coal and
other natural resources. Rising geopolitical tensions in the subregion and elsewhere in East Asia have already taken a toll on trade flows between some economies and made it more difficult to advance talks and negotiations on regional cooperation and integration. Domestically, the property market adjustment that has so far remained gradual and orderly may get out of control in case there is an external shock or turmoil in global financial markets. Rising household and business sector debt is also a major concern.

Although unemployment rates in the subregion are generally low, job quality remains a key concern. Although unemployment rates in the subregion are generally low, job quality remains a key concern. Labour markets have proven robust even in the midst of the weak global environment, and unemployment remains at low levels. The jobless rate in Japan stood at 4.3% at the end of 2012, whereas it was 2.9% in the Republic of Korea, in each case lower than it had been in 2011. In both countries, however, there are concerns that the quality of new jobs being created is declining, especially insofar as many new contracts are short-term and in the service sector. The urban unemployment rate in China was at 4.1% in the second quarter of 2012, although the quality of labour market statistics is not fully comparable with those of other major countries. Employment growth in Hong Kong, China is starting to slow, with a lag in response to weaker economic growth and corporate profits. According to the last labour force surveys for the fourth quarter of 2011, the unemployment rate in Mongolia was estimated at 9%, down from 13% in last quarter of 2010.

In the longer run, the subregion faces economic, social and environmental challenges to achieve or consolidate, depending on individual country circumstances, the evolution from middle- to high-income levels.

An increasing share of the population in Japan; the Republic of Korea; Hong Kong, China; and, to a lesser extent, China is now occupied in economic activities that are more technologically sophisticated, human capital-based and intensive in design and organizational capabilities than ever before. This is the result of considerable and sustained investments in education, advanced infrastructure, such as high-speed communications and broadband technology, and institutions that reward innovation and facilitate economic transactions. While the subregion’s achievements over the past 50 years are nothing short of extraordinary, there is no room for complacency. There are still considerable gaps in aligning people’s investment in acquiring innovative and organizational skills with the private returns from such efforts. These gaps appear particularly pronounced in the service sector, where productivity in the subregion is much lower than both in domestic manufacturing and in services internationally. Burdensome regulation that protects incumbent firms, including State-owned enterprises, and other vested interests hinders other efforts to enhance economic resilience and boost growth momentum.

The development of the service sector and the gradual transition to an economic model where domestic demand replaces external demand as the main source of growth are important to mitigate the trend of social exclusion that is gaining ground across the subregion. While economic growth has generally been accompanied by a reduction in absolute poverty, relative poverty – the share of the population living on less than half of the median income – is still surprisingly common, including in Japan and the Republic of Korea where relative poverty is the sixth and seventh highest in the OECD area. Inequality has also risen, driven by labour market dualism, high university tuition fees and growing household debt, as well as rigid norms for internal migration in the case of China. Gender inequality remains a concern in the subregion and Governments are taking measures to close gender gaps (see box 2.1).
Box 2.1. Resource allocation for social equality and inclusiveness: the experience with gender-responsive budgeting

Despite impressive GDP growth at the aggregate level, in East and North-East Asia the functional, spatial and gender distribution of income and wealth has become more unequal over time (OECD, 2011). In particular, gender inequality remains stubbornly high, as reflected in some indices. For example, the percentage of seats held by women in single or lower chambers of national parliaments in 2012 was 21.3% in China, 14.7% in the Republic of Korea and 10.8% in Japan. In fact in Japan the percentage fell even lower, to 7.9%, after the lower house election on 16 December 2012. These three countries also rank low in the annual World Economic Forum gender gap index, which is based on 14 indicators related to economic participation, educational attainment, health and political empowerment (they ranked 69th, 101st and 108th, respectively, among the 135 countries surveyed) (Hausmann, Tyson and Zahidi, 2012). In addition, the Republic of Korea has the widest gender wage gap among OECD countries at 39%, followed by Japan (OECD, 2012a; and 2012b).

Gender-responsive budgeting (also called “gender-sensitive budgeting” or simply “gender budgeting”) is one of the available policy tools to address gender inequality. Awareness rose during the 1980s that government budgets, instead of being gender-neutral, are in fact often gender-blind. The Beijing Platform of Action, adopted at the Fourth World Conference on Women in 1995, called for integration of a gender perspective into budgetary decisions on policies and programmes. Subsequently, the outcome document adopted at the Beijing+5 meeting called on all Governments to “[i]ncorporate a gender perspective into the design, development, adoption and execution of all budgetary processes, as appropriate, in order to promote equitable, effective and appropriate resource allocation and establish adequate budgetary allocations to support gender equality and development programmes that enhance women’s empowerment and develop the necessary analytical and methodological tools and mechanisms for monitoring and evaluation”.

Gender-responsive budgeting (GRB) is a form of gender-impact assessment that enables examination of the budgeting cycle at each step (conception, planning, approval, execution, monitoring, analysis and auditing) from a gender perspective, to ensure that resource allocation and utilization reduce existing gender inequalities and do not create new ones. GRB can be conducted at different levels of Government and include civil society groups, thereby enhancing citizens’ participation and inclusiveness in governance.

More than 70 countries around the world have engaged in gender budget initiatives in one form or another (UNIFEM, 2008). About half of OECD countries “always” or in “some cases” require GRB at all levels of Government. Within East and North-East Asia, the Republic of Korea has enacted a solid legal basis for GRB. Its National Finance Act of 2006 requires implementation of gender budgeting from 2010 onwards. Article 16 of the act stipulates that the Government “should evaluate the impact of public expenditure on women and men and try to reflect the results in the national budgetary allocation”. Other articles require each office to implement gender budgeting at both the planning and monitoring stages and to submit a gender balance sheet of their budget (Elson and others, 2009).

Thanks to the act, GRB in the Republic of Korea is considered one of the most comprehensive and progressive national schemes in the world. Various obstacles remain, however: lack of understanding on gender issues among officials, lack of gender-segregated data to analyse the current situation or to evaluate policy impact and the fact that the submitted gender budget sheet is not discussed in the National Assembly (Ma, 2008). Japan has only recently (from 2010) started to do so, by including the need to incorporate gender perspectives into all stages of the budgeting process in the Third Basic Plan for Gender Equality (Ichii and others, 2009). UNDP and UN-Women have assisted China and Mongolia in gender budget training for governmental officials.

Governments can benefit from GRB if they wish to ensure accountability to the public for policy commitments. By applying the same principles, the budget can be monitored to evaluate policy impacts on other vulnerable groups, such as the disabled, elderly, survivors of disasters and ethnic minorities.

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a This is the percentage of seats held by women in single or lower chambers of national parliaments, as indicated in The Updated Handbook on Indicators for Monitoring the Millennium Development Goals, http://mdgs.un.org (accessed on 20 December 2012).
b The Russian Federation ranked 59th and Mongolia 44th.
c See Report of the Fourth World Conference on Women, Beijing,4–15 September 1995 (United Nations publication, Sales No. E.96. IV.13), chap. I, resolution 1, annexes I and II.
e See General Assembly resolution S-23/3, annex, para. 73(b).
The Government of China unveiled comprehensive guidelines in February 2013 to improve income distribution in the country. The average real income of urban and rural residents will be doubled in 2020 from the 2010 level. The middle-income group will be expanded and the number of those living below the poverty line will be sharply reduced by 80 million by 2015. In China, poverty is mainly a rural problem and 128 million people were estimated to constitute the rural poor in 2011. The Government will enhance spending on social security and employment, and economic growth will be more consumption driven. The guidelines also offer directions on an extensive range of policy areas, such as taxation, subsidies, salary system, financial regulation, farmers’ incomes, household registration and social security. The local governments and various departments have been urged to map out supporting schemes and detailed rules for implementation of the guidelines. Effective implementation of the guidelines will help in reducing growing income inequality and accelerate the process of poverty reduction in the country.

Boosting potential growth and improving income inequality appear as common medium-term policy priorities across East and North-East Asia. Boosting productive capacity requires additional efforts to increase the labour force participation rate, especially for women, which is about 50% in Japan, Mongolia and the Republic of Korea and much lower than male rates of more than 65%, and to further prepare the population for the challenges of the knowledge economy. Measures to align service sector productivity with the levels prevailing in manufacturing and in developed countries would also ease the shift in sources of growth to domestic demand. Prompt action on these fronts, also drawing on best practices in Asia and the rest of the world, should pave the way for more inclusive growth.

Ageing is an additional challenge, as the subregion experiences the fastest demographic transition in the world, with the proportion of persons 65 years or older projected to rise from 1 in 10 in 2010 to 1 in 3 in 2050. Care of the elderly, including care for physical and psychological health, and social and income support, will have implications for fiscal sustainability and economic growth, but it is imperative for policymakers to recognize that older citizens can contribute to the economy and societies at large in their multiple roles as producers, consumers, transmitters of traditions, tenders of children in families, moral authorities in communities and so on.

The environment is the third dimension of sustainable development, and the subregion faces great challenges in this regard. In order to tackle them, individual countries have initiated various policies, in particular to reduce air pollution and its adverse impacts on human health and the environment. The Fourth Basic Environmental Plan of Japan includes both regulatory measures on pollutants and economic tools to protect the atmospheric environment. In the Republic of Korea, the Total Air Pollution Load Management System, an advanced environmental management system which rations annual total allowable emissions, has been implemented. The Government of China has made significant progress and has put forward its ambitious twelfth five-year plan to reduce by 2015 the level of sulphur dioxide in the air by 8% compared with that of 2010, despite the projected rapid increase in the number of power plants and vehicles. Mongolia also tightened the national standard for air pollution emissions from coal-fired power plants in 2011; however, outdated technologies and power plants, as well as increasing major emissions from informal settlements (gers) and mobile air pollution sources (old cars), still pose significant challenges. Policy coherence is a major problem to be addressed. A poignant example is the decision to make raw coal more affordable by reducing its price, while restricting its use in order to improve air quality.
In addition, various innovative policy measures have been taken to address local and global challenges to environmental sustainability and mitigate greenhouse gas emissions. All countries in the subregion promote sustainable transport, sustainable consumption and production, the greening of industry, expansion of green space and enhanced energy efficiency. Still, policy coherence will remain a particular challenge to make such measures more effective and efficient.

**NORTH AND CENTRAL ASIA**

**Growth slows across the subregion**

Growth in the North and Central Asian subregion as a whole slowed to 3.9% in 2012 from 4.8% in 2011 (see table 2.2). Most of the countries in the subregion are commodity exporters, and a larger group among those consists of energy exporters. These economies have strong economic linkages and energy-importing economies rely heavily on workers’ remittances from the Russian Federation and to a lesser extent from Kazakhstan. Some softening of high oil and gas prices contributed to somewhat lower growth rates in 2012 compared with that of the previous year.

The subregion as a whole has become more exposed to commodity-related risks than had been the case a decade ago.

In terms of export structure, the subregion as a whole has become more exposed to commodity-related risks than had been the case a decade ago, making the domestic economies vulnerable to a sharp decline in commodity prices (ESCAP, 2012b). For net energy exporters, the share of energy-related products in total merchandise exports increased from 53% in 2001 to 67% in 2010. Similarly, for metal and mineral exporters, the share of mineral products in total merchandise exports increased from 49% to 52%. Over the same period, the composition of economies in the subregion has also changed dramatically. Services have become the dominant sector for all net energy importers, while the industrial sector, including hydrocarbon and mining industries, remain the highest contributing sector in energy exporting economies, such as Azerbaijan and Turkmenistan. In addition, all net energy importers, with the exception of Georgia where the services sector accounts for about three quarters of GDP growth, the agricultural sector still accounts for large shares of employment and contributes to nearly one fifth of GDP growth.

In Armenia, there was strong performance in agriculture and industry, pushing up GDP growth from 4.7% in 2011 to 7.2% in 2012. Demand for Armenian metals and minerals remained relatively strong amid weak external conditions. Unlike several economies in the subregion, where agricultural sectors suffered losses caused by poor weather conditions, the country’s agricultural output grew strongly. The Government’s accommodative fiscal policy and support to small and medium-sized enterprises also contributed to a sustained growth. Growth of workers’ remittances slowed in 2012, partly due to a high base effect, but remained a major source of income generation, accounting for more than 10% of GDP.

Azerbaijan experienced a sharp slowdown in GDP growth to 0.1% in 2011, reflecting a contraction in oil production owing to repair work on the major oilfields. There was some improvement in oil production and that helped in raising GDP growth to 2.2% in 2012. Agricultural, construction and services sectors also contributed to improved growth. Nevertheless, this pace of growth is still much slower than its long-term trend. Sluggish growth in the major destinations for oil exports, namely the euro zone and China, also kept growth of the economy below its potential.

The economy of Georgia maintained a 7% growth rate in 2012, the same rate registered in 2011. A worsening external environment dampened demand for mining, quarrying and metallurgy products, and poor weather conditions weighed down the growth of agricultural output. However, robust growth in
manufacturing, financial services, transport and communications all helped to offset such negative consequences. Remittance inflows from Italy, Greece and the Russian Federation, the main destinations for Georgian workers, also slowed but held up relatively well. Remittances are important means for funding domestic consumption and accounted for about 8% of GDP. Increased government spending on infrastructure and public consumption contributed to GDP growth.

In Kazakhstan, GDP growth slowed to 5% in 2012 from 7.5% in 2011, reflecting lower export revenues and sluggish investment from the euro zone and the United States. The poor performance of the hydrocarbon and mining sectors weighed on growth. In addition, agricultural output suffered a sharp contraction due to severe drought conditions in the latter part of the year. The increased public social spending, the ongoing State-led investments in the development of the hydrocarbons sector, as well as the Government’s initiatives to diversify the economy through helping the manufacturing and construction sectors contributed to job creation and helped somewhat in boosting domestic demand and avoiding a rapid slowdown in economic growth.

Although the economy of Kyrgyzstan regained stability in 2011 after the sociopolitical crisis in 2010, the country’s economic performance in 2012 was subdued due to weak production of gold, a poor grain harvest and a slowdown in the economies of its trading partners. Gold production, accounting for nearly half of industrial production, was hindered due to a combination of difficult weather conditions and labour strikes at the Kumtor gold mine, the largest mining site in the country. Output of the manufacturing sector also fell, which led to a slowing of exports. On the positive side, remittance growth rebounded strongly, supported by the steady economic expansion of the Russian Federation. In 2012, the economy of Kyrgyzstan contracted by 0.9%; by comparison, in 2011 it recorded a positive growth rate of 5.7%.

In the Russian Federation, GDP growth decelerated from 4.3% in 2011 to 3.4% in 2012, resulting largely from sluggish global growth. Growth in the industrial sector slowed, but overall economic performance was relatively solid compared with other developed countries in the world. The unemployment rate hit a record low of 5.2% in mid-2012 as a result of increased public spending accomplished...
by a shrinking economically active population. Nevertheless, domestic demand started to weaken in late 2012, which weighed on the economic performance of neighbouring economies through reduced outflows of remittances. The performance of the economy of the Russian Federation has a large impact on other economies in the subregion through trade, investment and remittances channels.

The economy of Tajikistan expanded at a slightly more rapid rate of 7.5% in 2012 compared with 7.4% in 2011. A sharp rise in remittances and industrial expansion helped to prop up the economy amid external challenges. The agricultural sector, which accounts for two-thirds of total employment and one-third of GDP, also expanded strongly as it was unaffected by a regional drought that heavily damaged grain harvests in neighbouring countries.

Turkmenistan recorded another year of a double-digit growth, at 11.1% in 2012, compared with 14.7% in 2011. This still-robust growth amid weak external conditions was driven by strong hydrocarbon exports, especially gas exports to China, strong private consumption and public spending. Investment to enhance hydrocarbon capacity and production as well as new pipeline projects also further supported economic growth.

In Uzbekistan, GDP growth remained strong at 8.1% in 2012 but it was slightly lower than the 8.3% growth rate recorded in 2011. Growth in 2012 was driven mainly by the services sector. The economy was also assisted by rising investment through the Government's ongoing industrial modernization and infrastructure development programme for the period 2011-2015. Furthermore, unlike in other economies in the subregion, favourable weather conditions and abundant availability of water lifted the agricultural outputs of Uzbekistan. The recent increases in public sector wages and social payments also helped to sustain private consumption.

**Inflation eases during the first half of 2012 but subsequently picks up**

In most countries in North and Central Asia, there was a slowdown in inflation during the first half of 2012 but it picked up during the remainder of the year due to rising food prices caused by severe weather conditions in some countries in the subregion. For the year as a whole, inflation declined in all countries except Uzbekistan (see figure 2.4). Armenia, Azerbaijan, Georgia and Kyrgyzstan saw a sharp fall in the rates of inflation in 2012. In Armenia, agricultural recovery, moderating global commodity prices and appropriate monetary policy responses acted to contain consumer price inflation in 2012. Azerbaijan experienced inflation easing to 1.8% in 2012 from 8.1% in 2011, despite the fact that planned salary increases boosted domestic demand. Georgia saw weak deflation throughout 2012 as food prices continued to contract from the high base of the previous year. In Kyrgyzstan, inflation fell dramatically from 16.9% in 2011 to 2.8% in 2012, punctuated by a sharp contraction in economic activities, coupled with a slower pace of global food and fuel price increases.

In Kazakhstan, the Russian Federation, Tajikistan and Turkmenistan, rates of inflation slowed relative to the pace observed in 2011, although prices remained high. In Kazakhstan, food prices followed a declining trend during the first half of the year until they started rising again in mid-2012. In the Russian Federation, inflation exceeded the target rate of 5-6% in the second half of 2012, driven by services, fuel and food prices. However, inflation for the whole year was 5.1%, compared with 8.4% in 2011. In Tajikistan, inflation dropped to 5.8% in 2012, but high price pressures returned towards the end of the year. A regional drought pushed up significantly the cost of food imports; food costs account for about 70% of Tajikistan's consumer goods basket. Increased import duties on oil products, hikes in the electricity tariff and a sharp rise in the minimum
wage, which became effective in 2013, all contributed to consumer price inflation. In Turkmenistan, inflation slowed to 8.5% in 2012 from 12% in 2011. High levels of subsidies, regulated prices, particularly for utilities and food, and the deteriorating external economic climate contributed to the containment of inflationary pressure. However, robust growth in private and public consumption, coupled with a boost in public wages and transfers, served to prevent inflationary pressure from easing rapidly.

Unlike in other economies in the subregion, consumer price inflation accelerated in Uzbekistan, from 12.8% in 2011 to 13.2% in 2012, and remained well above the Government’s target band of 7-9%. This still high level of inflation is partly explained by public sector wage hikes and increases in welfare benefits. The poor grain harvest in Kazakhstan, owing to a drought, pushed up food prices, as Kazakhstan is one of the main suppliers of grain to Uzbekistan. This led to an increase in inflationary pressures in late 2012. Large inflows of gas-related foreign exchange and a continuation of expansionary fiscal policy also exerted upward pressure on prices.

Deterioration in fiscal balances

The budget balances of economies in North and Central Asia deteriorated in 2012, and most of them were in deficit (see figure 2.5). Weak global economic conditions and increased public spending contributed to widening budget deficits. The budget balances of the Russian Federation and Uzbekistan, both of which had recorded surpluses in 2011, were nearly balanced or slightly in deficit. By contrast, in Azerbaijan, Tajikistan and Turkmenistan, budget surplus increased in 2012.

Armenia, Georgia, Kazakhstan and Kyrgyzstan continued to experience budget deficits in 2012. The deficit decreased in Armenia from 2.8% of GDP in 2011 to 2.1% of GDP in 2012 owing to the Government’s effort to restrain its spending and improve tax and customs administration, including clamping down on tax evasion. In Georgia, the Government met its deficit target of 3.4% of GDP in 2012 despite an increase in social spending. The budget deficit of Kazakhstan increased to 3.1% of GDP in 2012 from 2.1% in 2011, due to higher
government spending. Weaker global economic conditions crimped tax revenue, although the sale of shares in State-owned companies and transfers from the oil fund supported budget revenue. In Kyrgyzstan, there was a large budget deficit in 2012, at 6.3% of GDP, which was much higher than the deficit in 2011, which was 5% of GDP, due to high levels of social and economic spending and difficulties with raising revenue. The impact of low gold production on government revenues was rather limited thanks to a revenue-smoothing arrangement between the Government and Kumtor Gold Company (IMF, 2012a).

The fiscal balance of the Russian Federation and Uzbekistan dropped into deficit or reached near balance in 2012. The budget of the Russian Federation was in balance in 2012. Although non-fuel revenues remained high, oil and gas revenues shrank because of a decline in oil prices. The Government of Uzbekistan continued to spend on social, defence and internal security measures and support infrastructure development and investment in basic services. The budget balance is estimated to have fallen into deficit in 2012, although the target of having the budget deficit not exceed 1% of GDP was met.

In sharp contrast to most economies in the subregion, Azerbaijan, Tajikistan and Turkmenistan maintained a budget surplus and that surplus even widened. The fiscal surplus of Azerbaijan increased from 0.6% of GDP in 2011 to 1.3% of GDP in 2012 thanks to rapid revenue growth from the low base of 2011. The revenues continued to be heavily reliant on transfers from the oil fund; more than half of such transfers were directed towards social and infrastructure projects, such as the reconstruction of infrastructure damaged by the earthquake in early 2012. In Tajikistan, a budget surplus expanded to 1.5% of GDP in 2012 from 0.8% of GDP in 2011 despite high social spending. The rise in government revenue was supported by an increase in sales and import taxes. In Turkmenistan, increased gas exports to China and the Islamic Republic of Iran as well as growing exports of oil provided a boost to revenues. The rise in public revenue enabled faster growth in public investment in hydrocarbons development, utilities, the rural economy and other major projects under the Government’s social and economic development programme for the period 2012-2016. The budget surplus increased to 1.4% of GDP in 2012 from 0.5% of GDP in 2011.
Central banks face a policy dilemma between supporting growth and taming inflation

Diverse monetary policy responses were adopted by countries in the subregion in 2012 to suit their circumstances. In the Russian Federation, there was a policy rate hike, while in Armenia its policy rates were kept on hold. A reduction in inflationary pressure and deterioration in external conditions enabled the central banks of Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan and Tajikistan to cut their policy rates. Given further slowing of economic growth and already low policy rates, the prospect of a rise in food price inflation in late 2012 posed a policy dilemma between supporting growth and containing inflationary pressure.

The central bank of Armenia also faced a policy dilemma between supporting growth and containing inflationary pressure. Although the refinancing rate has not been changed since September 2011, the bank’s conduct of monetary policy would have only a limited impact on inflation due to its weak institutional capacity and the relatively undeveloped domestic debt market. The central bank is now trying to broaden its policy tools gradually by increasing the use of such instruments as repurchase operations.

In contrast to most economies in the subregion, the central bank of the Russian Federation lifted the refinancing rate by 25 basis points to 8.25% in September 2012, as inflation exceeded the 6% upper limit of the bank’s target range around that period after a poor harvest had pushed up prices. Since then, the bank has kept the policy rate on hold due to a slowdown in the real economy. The central bank is now trying to shift the basis of monetary policy to inflation-targeting rather than containing fluctuations in the exchange rate.

Moderate export growth deteriorates current account balances

Energy exporters in the subregion — with the notable exception of Turkmenistan where the deficit remained sizeable in the services account — recorded current account surpluses in 2012, although the surpluses fell for all of them (see figure 2.6). Firm export prices for oil and natural gas were the main reason for this current account surplus.

In Azerbaijan, the current account remained in surplus at 20.5% of GDP in 2012. The country’s trade surplus remained sizeable as high global oil prices supported export revenue, while energy import demand weakened due to lower growth in economic activity.
prices helped to offset to some extent its widening deficit on the services account. FDI remained robust and largely directed towards the oil and gas sector. In Kazakhstan, the current account surplus narrowed to 4.7% of GDP in 2012 from 7.6% in 2011. The country’s persistent services deficit remained substantial, particularly that related to the hydrocarbon sector. In the Russian Federation, the current account remained in surplus at 4% of GDP in 2012. High oil prices were the main reason for the current account surplus as two thirds of export revenue came from oil and gas. Exports of other raw materials and basic manufactures, such as timber, metals and chemicals, accounted for much of the remainder. In Uzbekistan, the current account surplus narrowed to about 4.7% of GDP in 2012, from 5.8% in 2011, as global prices for their commodity exports, such as gold and cotton, declined. Although a fall in global food prices in early 2012 reduced import costs, demand rose for consumer goods and imported inputs for the country’s infrastructure development and housing construction programme.

Among net energy exporters, Turkmenistan is the only country in the subregion with its current account falling into deficit in 2012. Gas exports, especially to China, drove export growth and helped in maintaining a large merchandise trade surplus, while continuing rapid growth in imported services generated a sizeable services deficit.

In contrast to the healthy external account of the net energy exporters, the net energy importers continued to post large current account deficits in 2012. In Armenia, the current account deficit remained sizeable at 10.4% of GDP in 2012, as the worsening external economic conditions showed no sign of improvement in the trade account or a pickup in remittance inflows from Armenians working abroad. The current account deficit of Georgia also widened in 2012 to 12.7% of GDP from 11.8% of 2011. Export growth slowed sharply as economic conditions in key trading partners deteriorated. Georgia’s ability to attract FDI inflows was also weak in 2012 for the same reason. Although imports of Kyrgyzstan were tempered by falling food prices during the first half of the year, high prices for energy imports and increased demand for consumer goods worked in the opposite direction. International prices for gold have remained high, but a drastic curtailment of output from the domestic gold sector reduced export earnings. This divergence between export contraction and import growth intensified the external imbalance, which resulted in the current account deficit widening to 9% of GDP in 2012 from 6.3% of GDP in 2011. Similarly in Tajikistan, a drop in the global prices of aluminium and cotton

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**Figure 2.6. Current account balance in North and Central Asian economies, 2010-2012**

Sources: ESCAP, based on national sources; and International Monetary Fund, International Financial Statistics online database. Available from http://elibrary-data.imf.org/ (accessed on 30 March 2013); and Economist Intelligence Unit, Country Reports.

Note: Data for 2012 are estimates.
reduced export earnings, and increased import demand contributed to a widening trade deficit in 2012. The 2012 current account deficit widened to 5.8% of GDP in 2012, compared with 4.7% in 2011.

Future outlook and policy challenges

With oil and gas prices continuing to remain high, growth rates in 2013 in most economies are expected to be similar to those in 2012. However, if the euro zone economies suffer further setbacks, growth of the economies in North and Central Asia will slow due to strong economic linkages between the two groups.

The economy of the Russian Federation is projected to grow at 3.6% in 2013, slightly up from 2012. Increased oil production in Kazakhstan will push growth to 6% in 2013. In Armenia, Georgia and Tajikistan, export prices and demand will remain subdued, and higher inflation could hold back economic growth. In contrast, GDP growth in Kyrgyzstan is expected to rebound sharply to 7% in 2013 from a low base, driven by a boost to trade and remittances from a pick-up in growth in the Russian Federation and from higher gold production. Gold production and foreign sales of the metal returning to more usual volumes will be key factors if the economy is to keep growing in 2013. In Azerbaijan, hydrocarbon production is expected to stay below the pre-crisis levels, holding economic growth prospects at 1.5% in 2013. Turkmenistan is to a large extent isolated from the direct effects of turbulence on global financial markets and the euro zone crisis. Growth is expected to remain high at 8% in 2013, supported by rising gas exports to China and robust private consumption. Economic growth in Uzbekistan is expected to ease to 7% in 2013. The authorities are likely to retain many regulations on private-sector activity, including currency controls and high tariffs on imports, making it difficult to enhance foreign investment inflows. Ample revenue from commodity exports would further limit the incentive for undertaking far-reaching economic reforms.

Risks for the future derive from uncertainty about commodity exports, as countries in the subregion are highly reliant on exports of oil, gas, metals and other commodities. Despite the recent efforts of Governments to diversify the economies of their countries away from heavy commodity dependence, the subregion as a whole has become more exposed to commodity-related risks as compared with 10 years ago (ESCAP, 2012b). The importance of this long-term challenge is enhanced by the looming prospect of medium-term global economic growth which would dampen global demand and lower commodity prices. Countries must design and, more importantly, implement effectively those policies aimed at reducing their dependency on a few commodity exports, especially during the boom years when fiscal and external positions are still healthy relative to resource-poor economies. Moreover, the subregion needs to make more efficient use of its resources and generate a permanent income stream, rather than rely on a limited stock of resources. Transparency and accountability in decision-making as well as in implementation, which would entail monitoring the extraction of resources and putting in place anti-corruption reforms, are also vital.

With most economies in North and Central Asia being landlocked, the subregion faces high costs for transportation and the storage of goods. At the same time, however, a geographic feature of the subregion, which is located midway between Asia and Europe, affords an opportunity for it to serve as a transit zone and platform for trade between those two large consumer markets. Therefore, development of infrastructure is important to further accelerate growth in the subregion. Policymakers in the subregion have recognized the importance of being further connected to their neighbours and have embarked on a number of initiatives in this
regard. For example, the Central Asia-China gas pipeline, the first pipeline to bring natural gas from the subregion to China, was jointly developed by Kazakhstan, Turkmenistan and Uzbekistan together with China. The proposed trans-Afghanistan pipeline, which will connect Turkmenistan with India though Afghanistan and Pakistan, is another example of a project to be implemented in coming years. Further cooperation among the economies of the subregion could lead to the creation of transnational transport infrastructure, and the elimination of barriers and obstacles to the movement of goods and services could further accelerate development of these countries (Farra, 2012).

Food security is another challenge, as some economies in the subregion face relatively high levels of poverty and are vulnerable to swings in food prices due to high shares of food items in household expenditure. Poor weather in late 2012 in areas producing wheat and maize became the main cause of reduced harvests and consequent food price spikes all over the subregion. To counter these threats, Governments need to strengthen social safety nets to ensure household food security; lower domestic food prices through short-run trade policy measures or administrative action; and enhance longer-term food supply.

Sustained economic growth has brought about a reduction in unemployment in the subregion, although there are some marked differences in the performance of labour markets across countries. The unemployment rate reached historical lows in the Russian Federation, as job growth was accompanied by a shrinking population in the economically active age groups. The economy of Kazakhstan continued to generate employment at a pace just in line with the growth of the labour force. For low-income countries, unemployment rates are high but migration and remittances remained a channel to alleviate labour market tensions and support domestic demand.

Labour migration is another key concern of policymakers in the subregion (see box 2.2). The generalized economic slowdown could force many sectors employing migrant workers to a standstill, and potentially risk a rise in anti-immigrant sentiment. Policymakers in the subregion should be aware that migrant workers not only support their home countries through remittances but also play a key role in providing the labour needed in host countries, especially those countries with labour shortages, such as Kazakhstan and the Russian Federation. In the medium to long term, it is essential to strengthen social safety nets for migrant workers, generate employment opportunities at home and formulate regionally coordinated migration policies and laws.

The recent accession of the Russian Federation to the World Trade Organization (WTO) will have little immediate impact on the subregion, as most of the tariff cuts effectively will not come into force in the near term although they may generate additional positive growth impulses in the long term.4

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**Box 2.2. Recognizing economic contributions of migrant workers to host countries**

Several economies in North and Central Asia are highly reliant on remittance inflows of workers from other economies in the subregion, such as Kazakhstan and the Russian Federation. The economic and social contributions of migrant workers are typically well recognized in source countries. Remittances are found to be countercyclical and play an important role in sustaining domestic demand in source countries. Remittances are also an important source of foreign exchange, vitally needed for essential imports and for development activities. At the household level, remittances contribute to poverty reduction and human capital formation as well as to safety nets. In Tajikistan, workers’ remittances account for nearly a half of GDP, the highest proportion of remittances to GDP in the world. In other countries in the subregion, the value of such contributions is similar: remittances account for 29% of Kyrgyzstan’s GDP; and about 10% each of GDP of Armenia and Georgia (see figure A).
Among the nine economies in the North and Central Asian subregion, Kazakhstan and the Russian Federation are the net receivers of migrant workers, and the rest are net senders (see Figure B). The Russian Federation became one of the world’s largest recipients of migrant labour, with its estimated population of about 12.3 million migrants, equivalent to 8.6% of the national population and 12% of those in the working-age population, which is second only to that of the United States.¹

There is a common perception that migrant workers take away jobs, and their presence is seen as socially harmful for the host or destination countries. As many of the host countries in the ESCAP region started to feel the impact of the recent generalized economic slowdown, migrant workers could become exposed to backlash and rising anti-migrant labour feelings. As a result, migrant workers are now at greater risk in terms of their job security and access to basic social protection.

The anti-migrant labour feelings arise partly from a lack of sufficient studies showing the benefits that migrant workers bring to host countries. To understand that migrant workers are beneficial, one needs to ask a very simple question: Why do host countries allow these workers entry to work? They do so obviously because there is a shortage of particular types of workers in the host country. For example, most migrant workers in the Russian Federation are low-skilled, providing a source of cheap labour and filling niches in the labour market that do not appeal to local workers, such as in the construction sector.

Therefore, “migrant workers often supply manual skills, leaving native workers to take up jobs that require more complex skills – even boosting demand for them. Migrant workers replace ‘tasks,’ not workers” (D’Amuri and Peri, 2010). In fact, migrant workers do not compete with the native or domestic workers; instead, they complement them. Therefore, the popular notion of migrant workers taking away jobs or lowering the wages of native workers does not have strong empirical foundations. Migrant workers add to the prosperity of the host countries, as they play a key role in supplying much-needed labour. As a matter of fact, migrant workers are found to increase productivity, decrease costs to consumers and increase corporate profits (which means that employers do not have to relocate their operations to low wage economies). The benefit of migrant workers to the host countries becomes enhanced if they face demographic transition, with their working-age population shrinking.
Box 2.2. (continued)

The economic contribution of migrant workers to the host countries can be measured in different ways. One way is to look at the increase in GDP made possible due to migrant workers by the increasing supply of labour. However, it is argued that immigrants send home most of their salaries and wages. Even if it is assumed that migrant workers send home the entire amount of their wages and salaries, the total income generated by them is much larger due to complementarities between migrant and native workers and higher corporate profits, that is, the increment in GDP is much higher than the income of the migrant workers.

One approach to estimate this additional benefit uses the concept of consumer surplus (Borjas, 2010). Consumer surplus arises due to lower prices that consumers pay as a larger supply of goods or services is made available by the migrant workers. Prices also decline when migrant workers induce productivity gains through complementarities between them and native workers.

Based on this concept and using approximate values of the parameters and variables involved, the net benefit to the economy of the Russian Federation due to migrant workers is estimated to be 0.13% of GDP, or $2.5 billion per year. The gain from migrant workers in Kazakhstan, based on the same methodology, is estimated to be 0.57% of GDP, or $1.1 billion annually. These estimates clearly show that the net benefit to the two host countries is quite large, even if it is assumed that migrant workers remit their entire incomes back to their countries. In reality, migrant workers spend part of their incomes in the host countries and generate demand for products, such as food, housing, health care and entertainment, and a wide range of commercial services.

As a result, aggregate demand further rises, resulting in higher GDP. Migrant workers, by making available an increased supply of goods and services, also help control inflation. For example, Singapore used migrant workers very successfully to maintain macroeconomic stability and industrial restructuring, and thereby enhance its international competitiveness.

These gains could be further enhanced with improved working conditions and social safety nets for migrant workers because they would be more likely to invest in education for themselves and their children if they feel settled. Greater stability promotes integration and assimilation, both of which factors help the host country’s economy. Policymakers in the subregion have already realized the need for migration legislation, including social and legal protection for migrant workers, as they appreciate the role of migrant workers. They are also aware of the need to find ways to help migrants adapt and integrate with people and systems in host countries by, for instance, offering language training programmes. Appropriate regulatory frameworks should be formulated in a regionally coordinated and harmonized manner as immigration issues always intermingle with other legal problems. Meanwhile, authorities in the subregion are advised to avoid policies forcing migrant workers into vulnerable employment, which would expose them to serious risk of abuse and exploitation.

There is no denying the fact that migrant workers, especially illegal ones, sometimes cause social problems in host countries, but such situations could be minimized through the development of regionally coordinated migration policies and laws. In the medium to long run, it is also essential to strengthen social safety nets, address income inequalities and focus on generating employment opportunities at home.

Tajikistan’s entry to WTO in March 2013 as well as Kazakhstan’s membership, which is currently under negotiation, could further boost subregional economic activity. Meanwhile, Governments of countries in the subregion should continue to make progress in tackling corruption within the tax and customs administrations, strengthening the rule of law and the protection of migrant workers’ rights and ensuring fair business competition.

PACIFIC

The Pacific subregion has been divided into two distinct groups for analytical purposes. One group consists of Pacific island developing economies and the other, the developed countries, Australia and New Zealand.

Pacific island developing economies

Growth slows

In 2012, Pacific island developing economies experienced lower economic growth, averaging 6.4%, mainly due to the slowdown in growth in Papua New Guinea and Solomon Islands (see table 2.3). All the Pacific island economies, except Marshall Islands, Federated States of Micronesia and Tonga, improved their growth performance in 2011, averaging an economic growth rate of 7.9%, following the setback they had experienced during the global financial and economic crisis of 2008/09. The high economic growth rate in 2011 may be attributed mainly to resource-rich Papua New Guinea and Solomon Islands, as growth rates in the subregion remained low, averaging only about 2% for non-resource-based economies.

Many of the Pacific island economies are heavily dependent on the tourism and agricultural (including fisheries) sectors. However, their economic structure underwent some changes in the past decade, with declines in the contribution of the agricultural and industry sectors to GDP in some countries and the increasing and heavy reliance on the services sector. In Fiji, the contribution of the agricultural sector declined from 20.4% of GDP in 1990 to 12.1% in 2010, while in Samoa it declined from 18.5% of GDP in 1995 to 9.8% of GDP in 2010. However, in some larger countries the contribution of the agricultural sector increased, such as in Papua New Guinea, from 30.9% of GDP in 1990 to 35.9% of GDP in 2011, and from 28.9% of GDP in Solomon Islands in 1990 to 34.5% in 2005. The contribution of the industrial sector experienced some declines in many economies of the subregion. Except for Papua New Guinea and Samoa, the contribution of the industrial sector is about a quarter of GDP. In Papua New Guinea, the share of industry increased from 32.4% of GDP in 1990 to 44.6% of GDP in 2011, reflecting the domination of the mineral resource boom being experienced by the country. Owing to the large and growing tourism sector, the contribution of the services sector to GDP has been on the rise. In Fiji, the contribution of the services sector increased from 55.6% of GDP in 1990 to 68.6% of GDP in 2011 while in Samoa it increased from 51.9% of GDP in 1995 to 62% of GDP in 2011.

Papua New Guinea, the largest economy in the subregion, has been growing at high rates

Papua New Guinea, the largest economy in the subregion, grew by 9.2% in 2012 on top of growth of 11.1% in 2011, making it one of the better performing economies in the Asia-Pacific region. Much of the growth was driven by business activities associated with the construction of a liquefied natural gas (LNG) project and a high level of private sector investments and government spending. While there were some declines in the international prices of the country’s commodity exports, production at new nickel and cobalt mines boosted output in the mining sector, even though petroleum output continued to fall due to declining oil reserves. All other related sectors also performed strongly in 2012, led by construction and transport, as building of the new LNG pipeline reached its peak, and as a result of
higher than expected government spending. Strong performance of the economy is also reflected in persistent increases in the level of employment and private sector credit.

The economy of Fiji grew by 2.5% in 2012 compared with 1.9% in 2011. Growth was contributed by expansion of the agricultural and forestry sector and the manufacturing and fishing sectors and the impressive performance of the tourism sector. The Government invested heavily in the sugar industry in recent years but the total sugarcane crop is estimated to have decreased by 14% in 2012 due to the impact of floods in the early part of the year. The sugar industry remains beleaguered, partly as a result of the phasing out of the European Union’s preferential prices for imports of sugar from the country.

Solomon Islands is a relatively resource-rich country and achieved a high economic growth rate of 10.6% in 2011 but growth decelerated to 5.5% in 2012, partly due to weak global demand for commodities. Lower demand from Asia coupled with unfavourable weather resulted in lower production of timber and other agricultural commodities, even though there was some increase in gold output compared with that of 2011. Natural forest logging, which has been the leading export of the country for decades, is projected to decline in coming years. Mining, fisheries and tourism need to be further developed in order to offset the revenue and export losses from the decline in logging. In February 2013, a severe earthquake and tsunami in the coastal areas destroyed hundreds of houses, making thousands of people homeless. Devastation caused by the earthquake and tsunami will have an adverse impact on the economy.

Except for Cook Islands, Nauru and Palau, other Pacific economies dependent on tourism and remittances are barely growing. Vanuatu’s economy grew by 2% in 2012, somewhat lower than the

Table 2.3. Rates of economic growth and inflation in selected economies in the Pacific, 2011-2013

<table>
<thead>
<tr>
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<th>Real GDP growth</th>
<th>Inflationa</th>
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<td>Pacific island developing economiesd</td>
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<tr>
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<td>Developed countriesd</td>
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<td>New Zealand</td>
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a Changes in the consumer price index.
b Estimates.
c Forecasts (as of 30 March 2013).
d GDP figures at market prices in United States dollars in 2011 (at 2000 prices) are used as weights to calculate the subregional growth rates.
4.3% growth rate achieved in 2011. This reflects lower than expected tourist numbers and a decline in international prices of some of Vanuatu’s key exports, such as coconut oil, cocoa and kava, and slow progress in implementation of major public works projects.

The economic prospects of Nauru appeared weak until the recommencement of phosphate mining in 2007. Phosphate exports grew strongly in the first half of 2012 and contributed to the economy’s 4.9% GDP growth in 2012 compared with 4% growth in 2011.

Samoa’s economy, which is heavily dependent on tourism, remittances and foreign aid, grew by just 1.2% in 2012 compared with 2.1% in 2011. The country continued to receive increased levels of remittances, which grew by about 10% in 2012. However, tourist arrivals declined in 2012. Tourism growth in Fiji has been significant in the last two years and this could have deflected some tourists away from Samoa.

Tonga has not been able to improve its economic growth significantly since 2007. GDP growth was only 0.8% in 2012 falling from 2.9% growth in 2011. Remittances account for about 30% of GDP and a declining trend in these in recent years is partly responsible for low growth of the economy.

The economy of Kiribati is dominated by the public sector, with the main sources of income being derived from fishing licence fees, aid, remittances and the Revenue Equalization Reserve Fund, which was established with proceeds from the extraction of now-exhausted phosphate deposits. The economy grew again by 3% in 2012 which is unchanged from the growth in 2011, partly due to faster construction activities, funded by development partners. The Fund has been an important source for financing government expenditures when needed.

Largely driven by the tourism sector, the Cook Islands virtually maintained its economic growth at 3.3% in 2012. The Marshall Islands slowed to 1.9% growth in 2012, largely driven by public sector activity and the continued good performance of the fishing sector. Palau’s GDP growth at 4% in 2012, also driven by the tourism sector with strong growth from East Asian countries, was somewhat lower than in the previous year. The economy of Tuvalu, dominated by public sector activity, grew at a slightly higher rate of 1.2% in 2012, while Federated States of Micronesia also grew by only 1.4%.

**Inflationary pressures subside**

Inflation has always been a concern in many of the Pacific island developing economies despite the fact that many of them have had modest economic growth. Inflation in these economies is largely influenced by changes in external food and energy prices. Owing to slower economic growth and relatively lower global prices of food and energy, inflation slowed in 2012 in a number of economies in the subregion, including in Fiji, Kiribati, the Marshall Islands, Federated States of Micronesia, Nauru, Papua New Guinea, Samoa, Solomon Islands and Tonga (see figure 2.7). Kiribati and Nauru experienced deflation in 2012 mainly as a result of the appreciation of the Australian dollar.

Papua New Guinea recorded a lower inflation rate of 4.1% in 2012 compared with 8.5% in 2011. The appreciation of the domestic currency coupled with the country’s tariff reduction programme helped in containing imported inflation. Tightening of monetary policy also contributed to lower inflation. The education programme of the Government, which is free of tuition fees, curtailed the cost of education.

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**Tightening of monetary policy contributed to lower inflation in Fiji and Papua New Guinea**

In Fiji, inflation declined from 7.7% in 2011 to 3.5% in 2012. Monetary policy continued to focus on safeguarding foreign reserves and maintaining stable prices to support growth and investment. More recently, the liquidity position of the banks has increased significantly. Moderation in inflation in recent years was helped by more stable wages.
Inflation in Solomon Islands fell from 7.4% in 2011 to 5.9% in 2012, despite pressure from wage increases and a significant increase in the income tax-exemption limit. The liquidity position of the country’s banks improved but credit growth remained weak and had a dampening impact on inflation.

Samoa experienced a lower inflation rate of 2.1% in 2012 compared with 2.9% in 2011. Because of slower growth of GDP in 2012 and the winding down of tsunami-related construction, inflationary pressures are expected to subside in 2013. In Tonga, inflation decelerated from 6.2% in 2011 to 1.2% in 2012. Appreciation of domestic currency against the currencies of its major partners served to contain imported inflation.

Vanuatu had a relatively low inflation rate of 0.8% in 2011. However, it climbed to 1.4% in 2012. National elections held in 2012 led to higher than expected spending in the economy, which put pressure on prices. To promote investment and GDP growth, extension of credit to the private sector was increased. This also contributed to upward pressure on prices.

Diverse budget performance

Budget deficits were generally low in 2012, except in the case of Kiribati and Samoa where they were above 8% of GDP (see figure 2.8). Both Fiji and Papua New Guinea recorded a slight increase in budget deficit in 2012 but still it was well below 2% of GDP. On the other hand, Tonga and Tuvalu recorded budget surpluses in 2012, benefiting from foreign aid and grants and also higher fishing license revenues and lower spending in the case of Tuvalu.

In Papua New Guinea, the budget deficit increased to 1.2% of GDP in 2012 from 0.2% of GDP in 2011. The deterioration in the budget outcome reflects lower revenue collection as a result of declining commodity prices, particularly for gold and copper, combined with overspending, mainly related to national elections. It is planned that the 2013 budget will be increased by 23% in nominal expenditure, which will raise the size of the expected budget deficit to 7.2% of GDP. This significant economic stimulus is well timed to counter falling domestic demand as construction of the LNG project begins to wind down. Under the 2013 budget, the priority sectors of health, education, infrastructure
and law and order are being targeted. The budget allows for increased spending on education, mainly related to the implementation of the Government’s “free education” policy and transport infrastructure. Grants to provincial, district and local level governments have been increased significantly, signalling a major shift in the Government’s approach to delivering services to rural and remote areas. While the large increase in funding to provincial and local governments will directly transfer large amounts of funds to rural areas, it is expected that this will strain the capacity of the provinces to effectively implement the Government’s ambitious service delivery agenda. Moreover, Papua New Guinea is to be commended for taking steps to establish its Sovereign Wealth Fund which is expected to be operational by the end of 2013. The fundamental aim of the fund is to reduce the risks to Papua New Guinea of large fluctuations in mineral revenue due to changes in global commodity prices. The Papua New Guinea Sovereign Wealth Fund also consists of a Development Fund, which is to be an important source of financing for building infrastructure.

The budget deficit of Fiji increased slightly to 1.6% of GDP in 2012 from 1.4% of GDP in 2011. The national budget for 2012 was a bold one where significant reductions in personal income tax and company tax were implemented in order to spur consumption and investment in the country. Available data reveal that consumption expenditure increased but investment remained subdued. Recurrent expenditure dominated government spending, accounting for more than 80% of total expenditure. The budget deficit is projected to deteriorate further to 2.8% of GDP in 2013 mainly as a result of increased spending on capital and infrastructure projects, especially expenditures to upgrade infrastructure. The deficit will be financed through domestic borrowing and loans from the Export-Import Bank of China and the Export-Import Bank of Malaysia, a situation that raises long-term concern about the sustainability of government spending and debt levels, if these infrastructure investments do not attract private investment and improve productivity.

In Samoa, government revenue in 2012 increased by 9.9% even though external grants declined by 6.8%. On the other hand, its expenditure increased by 11.5%, mainly as a result of a sharp increase in current expenditures. These developments resulted in the budget deficit of Samoa increasing to 8.8% of GDP compared with a deficit of 5.3% of GDP in 2011. For 2013, the Government expects the budget deficit to decline, with revenue and grants expected to increase more rapidly, while expenditure, especially on infrastructure spending, is expected to increase at a slower rate.
The Cook Islands recorded a higher budget deficit equivalent to 2.2% of GDP in 2012 compared with 1.4% of GDP in 2011. Total revenue increased due to the reintroduction of a 15% withholding tax on interest from bank deposits. On the other hand, total expenditures increased more sharply, partly as a result of the higher cost of underwriting two Air New Zealand routes. Kiribati recorded a budget deficit, equivalent to 10% of GDP in 2012, which is better than the original estimate of 18.1% of GDP. The improved results in 2012 were due mainly to the increase in the fish catch and changes in the economy’s licensing scheme. The Revenue Equalization Reserve Fund remains the Government’s main source of deficit financing, but a recent drawdown has exceeded the Government’s annual target, which raises concern about the Fund’s long-term sustainability (ADB, 2012c).

Solomon Islands is among the countries in the Pacific that continued to record budget surpluses in recent years, but the budget recorded a deficit of 1.9% of GDP in 2012. Revenues from domestic sources, which account for two thirds of total government revenue, were higher in the first half of 2012 compared with the level in 2011. However, these were still well below 2012 projections, with overall revenues down by 10.4%. This development prompted the Government to limit its spending to mirror revenue shortfalls. The Government approved a supplementary budget of $35 million in September 2012. The additional spending was partly offset by reallocation of an unexpended development appropriation, which resulted in a smaller drawdown from cash reserves. Federated States of Micronesia has been enjoying budget surpluses in recent years. The budget surplus, at 0.4% of GDP in 2012, was unchanged from that of the previous year. The Government in late 2012 enacted revenue-enhancing measures, including a standardized value added tax, a net profit tax and the Unified Revenue Authority, which is responsible for the administration of tax laws. Nauru also recorded a budget surplus in 2012. The implementation of the new licensing scheme for foreign vessels contributed to higher revenues from fishing licences. Nauru passed a supplementary budget in October 2012 which forecast an extra A$ 8 million in revenue, mainly related to reopening of the refugee processing centre; most of the amount has been allocated for extra current expenditure.

Vanuatu recorded a budget deficit equivalent to 1.7% of GDP in 2012. The Government introduced a State-owned enterprise reform programme in 2012. These reforms should enable the Government to reduce fiscal pressures arising from operating losses of the State-owned enterprises.

**Current account deficits remain large**

The high and rising current account deficits in some Pacific island developing economies in 2012 were largely a result of poor export performance and a slowdown in overseas workers’ remittances (see figure 2.9). Overseas workers’ remittances relative to GDP are quite large in some of these countries. In Samoa and Tonga, remittances are more than 25% of GDP. These remittances not only provide support to balance of payments but also play a major role in these economies. The current account deficits of Kiribati, the Marshall Islands, Samoa and Tonga widened in 2012 as growth in the import of goods and services outpaced that of exports.

Papua New Guinea recorded a current account deficit of 28.4% of GDP in 2012. Lower international commodity prices and appreciation of the domestic currency had an adverse impact on exports. Investments in new resource-related projects led to higher imports. The deficit in the current account was also due to net service and income payments, which more than offset a surplus in the trade account and net transfer receipts. The level of foreign reserves at the end of June 2012 was sufficient to cover 10.8 months of imports.

Current account deficit in the case of Fiji also continues to be large, but it declined to 9.8% of GDP in 2012 from 10.1% of GDP in 2011. Both exports and imports grew by about 5%. The devaluation
of the Fiji dollar in April 2009 increased tourist arrivals considerably by making Fiji more attractive to tourists from Australia and New Zealand. In 2012, the tourism industry earned more than the combined revenues of the country’s top five merchandise exports. Foreign reserves remain comfortable and sufficient to cover 5 months of imports.

Samoa has only a limited number of exports. Higher import payments and a drop in export earnings led to a widening in the merchandise trade deficit in 2012. Although tourism earnings increased, there was a downturn in private remittances. As a result, the current account deficit widened to 11.4% of GDP in 2012 from 8.6% in 2011. The Samoan domestic currency strengthened against the United States dollar and the Australian dollar but weakened against the New Zealand dollar in 2012. The level of international reserves was sufficient to cover 5.3 months of imports in September 2012.

The current account deficit in Solomon Islands improved slightly in 2012 to 5.8% of GDP. During 2012, the Solomon Islands dollar appreciated against several major currencies, including the Japanese yen, the Australian dollar and the British pound sterling but depreciated marginally against the New Zealand dollar. At the end of June 2012, Solomon Islands’ foreign reserves were equivalent to 10 months of import cover.

Tonga’s current account deficit, at 4.2% of GDP in 2012, has changed little from the deficit in 2011, largely reflecting low private remittances and exports. To a large extent, the fall in remittances has been caused by a deterioration in employment and income growth in Australia, New Zealand and the United States. The seasonal workers programme, whereby local Tongans are provided employment picking fruit in Australia and New Zealand, is furnishing limited support to the growth of remittances, accounting for less than 5% of total remittances over the period from January to August 2012. The surplus in Tonga’s capital account narrowed but was still large enough to offset the current account deficit. The level of foreign reserves in August 2012 was sufficient to cover 8.2 months of imports.

**Future outlook and policy challenges**

The Pacific island economies are strongly linked to the neighbouring major economies of Australia and...
New Zealand. These economies are projected to grow by 2.5% and 2.3% respectively in 2013 and contribute to GDP growth of 3.4% for Pacific island developing economies as a group. Many of these economies are projected to grow at lower rates in 2013 than in 2012.

Papua New Guinea’s economy is expected to slow to 4% in 2013, partly due to the LNG project having already reached its peak levels of investment. The slowdown is also attributed to the reduction in global market prices of gold and copper in 2012. In addition, prices of other commodities, such as timber, coffee, cocoa, palm oil and copra which comprise 20% of the country’s exports, also declined, and this could have a negative impact on incomes of the rural poor. Fiji’s economy is projected to grow at a slightly higher rate of 2.7% in 2013. The current constitutional process and the plans to hold general elections in 2014 could inspire confidence in the country and attract better levels of investment in coming years, thereby promoting economic growth. Solomon Islands benefited from high commodity prices, particularly for timber in previous years. However, there is concern that the current rate of timber logging is far beyond the sustainable rate; exports could continue to decline and may virtually cease in coming years.

The severe earthquake that occurred in February 2012 is expected to have an adverse impact on growth in 2013. Australia’s utilization of Nauru as a processing centre for refugees is expected to boost economic activity in Nauru, and this is likely to raise the level of growth in coming years by improving the retail and services sector and by generating employment in the country. Nauru’s economy is projected to grow by 8% in 2013.

Despite the development of new tourism infrastructure, including hotels, in coming years, Samoa could face capacity constraints, which would result in higher-priced tourism products and services. The economy is expected to slow down and grow by 0.9% in 2013. Vanuatu’s economy is projected to grow further by 3.2% in 2013 driven largely by construction and infrastructure development and the tourism sector. Remittances from the United States accounted for about 14% of Tonga’s GDP in the 12 months to August 2012. As the United States economy gradually recovers and unemployment falls, remittances to Tonga are expected to improve. This combined with construction and infrastructure projects along with the tourism sector could help Tonga’s economy to grow by 0.5% in 2013.

Among the various challenges being faced by these small island economies is their narrow base and high dependence on subsistence agriculture and tourism; in some cases, the mining sector plays a major role. Diversification of these economies will always remain a challenge. However, the subsistence agricultural sector can be further developed, and its productivity should be enhanced. The involvement of the private sector and the role of Government as a facilitator in improving agricultural productivity are important. Pacific island developing economies need to invest heavily in physical infrastructure (roads, ports, water and electricity) and in research and development in agriculture.

The tourism industry plays an important role in these economies. There are two challenges for Pacific island economies in promoting the tourism industry as a driver for economic growth. The first challenge is to ensure that the benefits of tourist spending have a large multiplier effect. This can be done through linking the tourism industry to local production. Supplying agricultural products to hotels in the tourism sector could spread the impact of the money spent by tourists. Fiji is probably the only country which is now in a position to supply some of the needs of hotels locally, but even there much of the food items for hotels is imported. These economies would need to improve the infrastructure and value chain in order to ensure that the agricultural sector is well linked to the tourism industry. The second major challenge is to ensure that the pristine environment is managed well. The
Young people make up a large proportion of the population of the Pacific island developing countries. Young people in the age group of 15-24 years account for nearly one fifth of the total population and one third of the total working-age population. Almost one quarter of the total population is in the wider age group of 15-30 years, and the more populous Pacific island countries are facing a “youth bulge”— the proportion of youth in the population is much higher than that of other age groups (UNICEF and SPC, 2011).

Younger people are disproportionately unemployed in the Pacific, and youth from all across this subregion have identified lack of employment opportunities as the top problem facing their generation (UNICEF and SPC, 2011). For example, those between the age of 18 and 30 accounted for one third of the Fiji labour force in 2004/05, but accounted for almost two thirds of the total unemployed. In Kiribati, young people 15-24 years of age made up a quarter of the labour force in 2005 but made up 58% of the unemployed (EPOC, 2007). In Tonga, youth accounted for 42% of the total unemployed in 2003. The magnitude of the unemployment problem among the young people might be even higher than these figures suggest, as many youth might drop out of the labour force and give up looking for jobs once it becomes clear that few opportunities exist. The extent of the problem is so severe that an ESCAP report compared unemployed youth in the Pacific to a “social time bomb” (EPOC, 2007).

There are several causes of high youth unemployment in the region. First, economic growth is an absolute prerequisite for providing employment opportunities, and only an expanding economy can provide jobs for a growing labour force. However, most Pacific economies are growing very slowly and cannot keep pace with the increasing number of young people entering their labour forces every year. Additionally, young people are also less experienced and thus face structural disadvantages compared with older cohorts in an already squeezed labour market. Second, in most Pacific island developing countries there is a great mismatch between skills gained through the education system and the skills required to be employed given the country’s economic structures (ILO, 2010a; World Bank, 2009). While the curriculum of most educational institutions prepares students for jobs in the formal sector, there are very few jobs in that sector. The few that exist are predominantly based in the public sector and in urban areas. Given the high population growth and low economic growth rates, it is inevitable that young people in the Pacific will end up in the informal sector (ILO, 2010b), and the education system does not increase a young person’s employability in the informal economy. This results in a large number of school leavers — for example, half of school leavers in Fiji in 2005 — not having a job in the formal sector and not having any skills to use in the informal sector (World Bank, 2009). The weak linkages between education and the job market are often exacerbated by the lack of support/counselling furnished to students concerning opportunities available after they leave school (UNICEF and SPC, 2011).
Pacific island developing countries also exhibit skilled labour shortages, both in the formal and the informal economy. The informal economy consists of minor processing and merchandising in primary produce, the provision of services such as carpentry and mechanical repairs, transport, handicrafts, and small-scale vending. Skill gaps exist in all these activities and there is a lack of training for workers in the informal economy (ILO, 2010b). Employment and income growth in the informal economy is further hindered by the inability to commercialize economic activities, lack of secure individual land tenure, difficulty in accessing loans to start businesses and the lack of basic business skills. For very specific job opportunities in the formal economy, in areas such as mining, hospitality or mechanical repairs, technical and vocational education and training is available but it is often inadequate (World Bank, 2009). It is considered as a second option for people who “fail” the mainstream schools. Additionally, such training schools do not coordinate with industries to design and prepare their curriculum. As a result, the students are not taught to standards agreed with the industry, and the industry does not consider the students trained and employable. Therefore, while there is high unemployment in the labour market, this co-exists with skill shortages in specific occupational areas.

Private sector development to increase formal sector jobs, reforming education policies to decrease the mismatch between skills taught by educational institutions and the skills required in the labour market, improving young people’s access to land and capital to foster entrepreneurship and self-employment, and youth-focused active labour market programmes (training, employment services, self-employment assistance and information services) can help young people in the Pacific find meaningful employment in both the formal and informal sectors.

There have been some efforts in the region to tackle the issue of youth unemployment. The Pacific Youth Strategy 2010 was developed in 2005 as a strategic regional framework to guide the development of young people in the region. This framework was derived from national and regional consultations with stakeholders — including youth (SPC, 2012). A review of the strategy reveals several initiatives across the Pacific to support youth employment. For example, Fiji commits itself to community-based training centres to enable youth skills training; Kiribati commits to establishing training centres for youth outside the formal education system; and Tonga commits to developing a national pilot skills set project to improve access to training in emerging areas related to economic needs and youth (SPC, 2012). The National Youth Policy 2007-2010 of the Cook Islands included strategic interventions to engage young people in the two of the country’s main economic activities: fishing and pearl farming. The interventions provided young people with training on fishing methods, maintenance and accounting and marketing skills — things directly relevant to economic needs.

While more work on long-term strategies is required to adopt innovative labour market and growth strategies in the region, migration for work can be a short-term solution to the issue of youth unemployment (Asia Pacific Interagency Group on Youth, 2011). Mobility of unskilled labour to Australia and New Zealand, through seasonal work schemes for example, could provide some temporary relief to the high youth unemployment situation in the Pacific. Existing schemes, such as the Recognised Seasonal Employer Work Policy in New Zealand and Australia’s Pacific Seasonal Worker Pilot Scheme (made permanent in July 2012 as the Seasonal Worker Programme), have been hailed as a success. Governments of Pacific island economies have argued that more needs to be done, in terms of numbers and sectoral coverage, and in ensuring greater certainty for such schemes. Moreover, existing schemes do not cover all Pacific island countries; as a result some opportunity is being lost. Any employment scheme related to youth migration should operate within a policy framework that focuses on the particular vulnerabilities youth face in these settings and increasing awareness of their rights and entitlements, and should also look at how such schemes could contribute to professional and skills-development in the country of origin.

remittances cannot help in the provision of public goods, such as roads, water supply and power supply, as well as education and health-care services. Aid will also be important in helping the countries in dealing with the impacts of climate change.

Despite their small size and remote location, Pacific island developing economies have growth potential but unlocking this requires the development of appropriate institutional environments, including reforming the investment and communication technologies sector (ADB, 2012c). For example, Fiji, Samoa, Tonga, Solomon Islands and Vanuatu have introduced competition among mobile phone service providers, leading to substantial reductions in costs. Thus economic reforms that lead to productivity increases, such as opening internal telecommunications and airline services for competition, opening trade and investment channels and improving education and training, become even more critical for these small island economies if they are to exploit fully their growth potential.

For the Pacific island economies, the effects of climate change and natural disasters are well known. For some of them, the implications are serious as they not only affect their short-term growth and development prospects but could threaten their very existence if predictions of a rise in sea levels are borne out. A policy challenge for them is to focus on adapting to climate change and reducing their vulnerability to its effects, rather than on trying to mitigate it. However, the resources available to these economies to implement national adaptation programmes are scarce. It is now accepted that, for the Pacific islands developing economies with sufficient resources and technology transfer, adapting to climate change can be turned into an opportunity to create a new approach to development based on sustainability. Applying improved agricultural practices, adopting clean technologies, enhancing energy efficiency and making modern and clean energy available to the poor would help to simultaneously fight climate change and promote sustainable development in these countries.

To deal with some of the above challenges, Pacific island developing economies need to strengthen cooperation among themselves. They are part of various regional organizations and discuss many issues of interest. However, the achievement of better and deeper regional integration would be in the long-term interest of these economies. Regional cooperation will enable them to reduce the cost of doing business and improve public services. These economies are strongly linked to the neighbouring major economies of Australia and New Zealand. Some bigger countries, such as Fiji, Papua New Guinea and Solomon Islands, have undertaken several initiatives for enhancing trade and investment links with their Asian neighbours. Papua New Guinea is currently a member of Asia-Pacific Economic Cooperation and has observer status in the Association of Southeast Asian Nations (ASEAN). Papua New Guinea’s exports to China, for example, increased from $122 million in 2001 to $817 million in 2011 on the back of increasing Chinese demand for Papua New Guinea’s petroleum products. Meanwhile the exports of Solomon Islands to China, dominated by timber logs, reached $348.4 million in 2011. Many countries also import at least 10% of their total imports from China. Infrastructure investment in many of these economies has been bolstered by funding from the Government of China. Trade and investment linkages between Pacific island developing economies and Asia are likely to continue to expand due to low transportation costs. However, their long-term economic prospects will depend more heavily on their capacity to seize opportunities in a changing global landscape.

Australia and New Zealand

Growth performance improved steadily

In Australia, GDP growth accelerated to 3.6% in 2012 from 2.5% in 2011 when the country suffered from severe floods (see figure 2.10). Total fixed investment growth surged to a multi-year high in mid-2012 on stellar resource investment that benefitted from high commodity demand from Asia. However,
the overall picture was uneven; investment beyond the mining sector was much more subdued. A huge expansion in the mining sector and high commodity prices are contributing to strong economic growth of the country. Meanwhile, steady wage growth, stable inflation and low interest rates supported private consumption, although high household debt and higher unemployment towards the end of 2012 held back consumer confidence somewhat. The housing market displayed some signs of improvement in mid-year after a continuous fall in house prices, which benefited from lower mortgage costs.

In New Zealand, the economy continued to recover at a steady pace. GDP growth strengthened to 2.5% in 2012 from 1.5% in 2011. Favourable weather conditions supported agricultural output in the early part of the year. Reconstruction effort following major earthquakes in late 2010 and early 2011 helped to boost fixed investment and fuelled the construction sector, albeit with some delays due to earthquake aftershocks. Private consumption growth was subpar on elevated unemployment rates and a fragile housing market. Exports of goods and services also contracted, particularly in the first half of 2012, partly weighed down by the strong domestic currency.

**Moderate inflationary pressures**

Consumer price pressures remained moderate. Australia’s inflation softened to 1.8% in 2012 from 3.3% in 2011, thus it was comfortably within the official target range of 2-3%. The introduction of a carbon tax in July 2012 pushed up electricity prices but the overall inflation impact tended to be moderate. Near-term inflation is likely to be tempered by fragile private consumption. The strong domestic currency would also help to limit imported inflation but its effect should gradually fade.

Inflation in New Zealand softened to 1.1% in 2012 from 4% in 2011. This is at the lower end of the official inflation target range of 1-3%. Lower imported commodity prices, below-trend private consumption growth and the strong currency kept the price pressures at low levels. Inflation is expected to edge up slightly in 2013 on stronger domestic demand and continued reconstruction activities in the wake of earlier earthquakes that have reduced spare capacity.
Subdued global economic growth and strong currencies weigh down exports

Despite still strong export volume, an economic slowdown in China, Australia’s largest trading partner, has pushed down export prices of key commodities, such as coal and iron ore. The currency appreciation, mostly due to high commodity demand as well as higher interest rates relative to most other advanced economies, added more pressures on export earnings. By end-2012, the Australian/United States dollar exchange rate reached 0.96, or 33% stronger compared with the rate at end-2008. In addition to shipments, the strong Australian dollar also affected trade in services, such as receipts from tourism and overseas students. In contrast, imports continued to increase solidly on capital goods imports for the mining sector and more generally strong domestic currency. Trade deficits widened further in late 2012. Overall, the current account deficit increased to 4.1% of GDP in 2012 from 2.3% of GDP in 2011.

New Zealand’s current account deficit also increased. About three quarters of total exports of the country are commodities, so the weak global economy and commodity prices have constrained export growth. The impact of China’s slowdown is also channelled through Australia, which is New Zealand’s top export destination. Strong domestic currency also depressed exports of goods and services further. With robust imports for reconstruction activities and anaemic exports, the current account deficit rose to 5.4% of GDP in 2012, from 3.3% in 2011.

Fiscal policy remains supportive of economic growth

The Australian Government previously announced an effort to regain a small fiscal surplus in the fiscal years ending in June 2013 and June 2014. The tightening was focused on both spending cuts and stronger mining tax revenue that benefit from a new levy on mineral resource profits introduced in July 2012. The consolidation plan was later postponed in late 2012 as economic growth moderated and tax revenue was lower than expected. The fiscal surplus would have been a major turnaround from a deficit of 3% of GDP in the fiscal year ending in June 2012. The Government implemented a carbon tax in 2012 for a greener economy. In New Zealand, the fiscal cost of reconstruction is considerable. It is estimated that the fiscal deficit would moderate to about 4% of GDP in the fiscal year ending in June 2013 from more than 6% of GDP in the preceding fiscal year. Fiscal consolidation is planned over the medium term. The Government has targeted a modest fiscal surplus of 0.1% of GDP in the fiscal year ending in June 2015. Although spending cuts will account for a large part of savings, the Government also plans to enhance non-tax revenue by partial privatization of some State-owned assets.

Monetary policy eased

The monetary policy stance in Australia eased steadily over 2012 to support economic growth. The policy interest rate of 3% at end-2012 was already 175 basis points below the level in October 2011. Monetary policy in New Zealand is also conducive to growth. The policy interest rate has been maintained at 2.5% since March 2011 when it was cut by 50 basis points after the earthquake. In Australia and New Zealand, the policy interest rates at end-2012 were similar to the troughs observed during the global financial turmoil in 2009.

Economic outlook is favourable but risks are tilted to the downside

Despite some slowing of mining activities towards the end of 2012, mining exports have picked up in recent months. As a result, Australia’s output growth is expected at 2.5% in 2013, supported mainly by mining exports to Asian countries, particularly China. Private consumption growth is likely to be sustained on strong mining employment growth and low interest rates, although an uncertain global economy could weigh down consumer confidence. In New Zealand, output growth is projected at 2.3% in 2013, as the reconstruction effort gradually gains momentum. Fiscal tightening and fragile consumer spending are possible headwinds.
For both economies, the downside risks are mostly external, particularly a recession in the euro zone and a slowdown in China. While direct trade exposure with the euro zone is limited and the banking sectors remain generally healthy, the financial sector risk is sizeable; it is a result of large foreign wholesale funding to finance the current account deficit. This risk could materialize if market confidence suddenly plunges and systemic financial risks heighten. In Australia, the significant role played by the mining sector also highlights the country’s vulnerability to terms of trade shocks. Large mining companies have announced some scaling back in their investment plans. Strong domestic currencies, particularly the Australian dollar, would continue to add pressures on overall export growth and competitiveness. Nonetheless, both economies appear to have ample room for macroeconomic policy responses, if needed.

SOUTH AND SOUTH-WEST ASIA

Growth slows due to both external and domestic factors

Across South and South-West Asia, the economic outlook shows a marked slowdown to a subregional average of 4.1% in 2012, from 6.4% in 2011, partly due to stalled export growth rates as a result of the global economic slowdown (see table 2.4). Another important component of the subregional slowdown is a result of monetary tightening in the previous two years aimed at curbing inflationary expectations. The high incidence of natural disasters, such as floods and droughts in different parts of the subregion, and infrastructure bottlenecks, in particular power shortages affecting the industry, also contributed to slower growth. To the extent that these constraints are home-grown, Governments that respond to these policy challenges have the potential to substantially improve their growth momentum, despite continued global weaknesses.

The economies of the subregion have undergone a structural transformation over time, moving from being dominated by the agricultural sector to becoming services-driven, with services contributing over half of GDP and agriculture representing less than one-fifth of GDP in most countries. Nepal, whose agriculture sector was 38% of GDP in 2011, remains an exception. The industrial sector in countries of the subregion has stagnated in terms of its contribution to GDP since 1990, staying under 30% in most cases. (SRO-SSWA, 2012).

Table 2.4. Rates of economic growth and inflation in South and South-West Asian economies, 2011-2013

<table>
<thead>
<tr>
<th></th>
<th>Real GDP growth</th>
<th>Inflation³</th>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>South and South-West Asia</td>
<td>6.4 4.1 5.1</td>
<td>9.4 11.1 8.5</td>
<td></td>
<td></td>
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<tr>
<td>Afghanistan</td>
<td>5.7 6.9 6.5</td>
<td>11.8 9.0 7.5</td>
<td></td>
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<tr>
<td>Bangladesh</td>
<td>6.7 6.3 6.0</td>
<td>8.8 10.6 7.5</td>
<td></td>
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</tr>
<tr>
<td>Bhutan</td>
<td>11.7 8.5 8.4</td>
<td>8.3 13.5 7.8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>India</td>
<td>6.2 5.0 6.4</td>
<td>8.4 10.0 7.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Iran (Islamic Republic of)</td>
<td>4.0 -0.9 0.8</td>
<td>21.5 25.2 21.8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maldives</td>
<td>7.0 3.4 4.3</td>
<td>11.3 10.9 8.3</td>
<td></td>
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</tr>
<tr>
<td>Nepal</td>
<td>3.8 4.5 4.0</td>
<td>9.6 8.3 7.5</td>
<td></td>
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</tr>
<tr>
<td>Pakistan</td>
<td>3.0 3.7 3.5</td>
<td>13.7 11.0 8.5</td>
<td></td>
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</tr>
<tr>
<td>Sri Lanka</td>
<td>8.0 6.2 6.5</td>
<td>6.7 7.6 7.3</td>
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<tr>
<td>Turkey</td>
<td>8.6 3.2 3.8</td>
<td>6.5 8.9 7.6</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: ESCAP, based on national sources.

a Changes in the consumer price index.
b Estimates.
c Forecasts (as of 30 March 2013).
d GDP figures at market prices in United States dollars in 2011 (at 2000 prices) are used as weights to calculate the subregional growth rates.
e The estimates and forecasts for countries relate to fiscal years. The fiscal year referred to as 2011 in the table is defined as follows: from 1 April 2011 to 31 March 2012 in India; from 21 March 2011 to 20 March 2012 in Afghanistan and the Islamic Republic of Iran; from 1 July 2010 to 30 June 2011 in Bangladesh and Pakistan; and from 16 July 2010 to 15 July 2011 in Nepal.
The economy of Afghanistan has been growing at high rates in recent years despite the continuing adverse security situation and the challenges associated with building political and economic institutions. GDP growth averaged more than 10% annually over the previous 5 years prior to 2011. Strong investment in the construction sector, much of which is linked to donor-led development projects, has been providing a boost to economic growth. Growth slowed considerably to 5.7% in fiscal year 2011 due to contraction of the agricultural sector as a result of poor weather conditions. The economy is estimated to have grown by 6.9% in 2012 with improved performance of the agricultural sector. The country is known to have huge mineral deposits – worth nearly $1 trillion according to some estimates – of oil, gold, iron ore, copper, lithium and other minerals. With an improved security situation, the extraction of those minerals could provide a big boost to the economy in the future. However, right now heavy dependence of the economy on external funds – aid expenditure being equivalent to more than two thirds of GDP – is a cause for concern. Gradual withdrawal of external funds in the coming years could lead to a slowdown in economic growth. To enhance economic self-reliance, strengthening of the domestic economy through better economic governance, improving the efficiency of public spending, decreasing capacity constraints and strengthening the overall business environment should be pursued more vigorously.

The Government of India introduced reforms to boost investment, including allowing foreign investment in multibrand retail, civil aviation and broadcasting services.

The economy of Bangladesh emerged largely unscathed from the effects of the global financial and economic crises. GDP grew by more than 6% over the period 2009 and 2012. Growth marginally slowed to 6.3% in 2012 from 6.7% in 2011, mainly due to slower growth of the agricultural sector. The industrial sector improved its growth performance as a result of faster growth of small-scale industries supported by the Bangladesh Bank’s inclusive finance initiative. Growth performance of the services sector was virtually the same over two years. All sectors of the economy benefited from government initiatives to overcome infrastructural bottlenecks in the power, energy and communication sectors.

The economy of Bhutan is heavily dependent on the production of hydropower and exporting the output to neighbouring India. Hydropower projects have boosted the construction sector. Revival of the tourism sector has also contributed to the expansion of the economy, as GDP grew by 8.5% in 2012 after expanding by 11.7% in 2011. Bhutan is currently formulating its eleventh five year plan for 2013-2018 to take effect in July 2013. The plan is aimed at increasing the country’s self-reliance, which entails a strategy that focuses on sustainable development so that economic growth is not achieved at the expense of environmental degradation and “gross national happiness” is maximized. This will be attained by concentrating on 16 different “key result areas”, including, among others, economic growth and food security, and on vulnerable groups.

In India, economic activity slowed considerably in 2012. While the global slowdown is having an adverse impact on exports and consequently on economic growth, domestic demand particularly investment witnessed slower growth as well. Severe tightening of monetary policy in previous years to contain inflation and anchor inflationary expectations has contributed greatly to this. GDP growth moderated to 5.4% during the first half of fiscal year 2012. In September 2012, the Government introduced reforms to boost investment, including allowing foreign investment in multibrand retail, civil aviation and broadcasting services. It also partially phased out fuel subsidies and adopted a five-year roadmap for fiscal consolidation. Subsequently, the Government raised the ceiling on FDI in the insurance and pension sectors. The successful implementation of these measures should help foster recovery later. Growth for the year as a whole is estimated at 5% as compared with 6.2% in 2011. On the output side, growth of the agricultural sector slowed due
to poor weather conditions. Manufacturing output stagnated as external demand as well as domestic investment and private final consumption expenditure decelerated. Services sector growth also slowed as there were adverse impacts on activity in trade, transport, hotels and communications in view of the sector's linkages with the rest of the economy.

The economy of the Islamic Republic of Iran heavily depends on the export of oil. Economic sanctions against the country related to its nuclear programme were tightened further by the European Union and the United States. These sanctions along with overall declining oil production and a cut in subsidies are having negative impacts on economic growth. Although the subsidy reductions had been announced in advance, the unexpected scale of the changes and high inflation depressed private consumption despite some compensatory cash handouts by the State. The programme of making further reductions in subsidies has been halted now. The economy is estimated to have contracted by 0.9% in 2012 compared with its 4% growth rate in 2011. To promote economic self-sufficiency, the Government discouraged the export of agricultural goods, such as wheat, flour and sugar, and industrial products, including steel, aluminium and other metals. The Government is prioritizing investment in the oil and gas sectors to arrest falling output.

The economy of Maldives is heavily dependent on the tourism and fisheries sectors. With moderation in growth of the tourism sector due to the global economic slowdown, GDP grew by 3.4% in 2012 as compared with 7% in 2011. Higher growth in 2011 was underpinned by strong growth in the tourism sector and related sectors, such as transportation, construction and communications.

Low growth in Nepal in recent years has largely been due to political instability, frequent strikes in the country, persistent labour problems and severe electricity shortages. However, GDP growth improved to 4.5% in 2012 from 3.8% in 2011. While performance of the agricultural sector improved due to favourable weather conditions, the industrial and services sectors recorded improved growth rates also. Due to relatively faster growth of the services sector, the share of this sector has been rising in GDP at the expense of the agricultural and industrial sectors.

The economy of Pakistan is passing through a phase of low growth. However, there was improved performance in 2012 despite numerous challenges, including heavy rain and flooding in southern parts of the country, increases in fuel and commodity prices, the global slowdown and weak capital inflows. GDP grew by 3.7% in 2012 as compared with 3% in 2011. The agricultural sector performed better than in 2011. As for manufacturing, its performance improved; prominent subsectors registering an improvement in growth were sugar, cement, automobiles, textiles and chemicals. The construction sector staged a strong recovery. Higher growth in the industrial sector as a whole was achieved despite shortages of electricity and natural gas. In sum, the commodity-producing sector achieved a higher growth rate in 2012. On the other hand, the services sector witnessed somewhat slower growth. On the demand side, consumption, both private and public, grew at a higher rate in 2012 but investment declined. As a result, investment fell to 12.5% of GDP in 2012 from 13.1% of GDP in 2011.

The economy of Sri Lanka expanded on average more than 8% annually during 2010 and 2011. The high growth momentum was supported by an improved macroeconomic environment, increased capacity utilization, expansion of economic activity in Northern Province and Eastern Province and enhanced external demand. This strong growth momentum continued into the first quarter of 2012, but growth gradually moderated from the second quarter onwards in response to policy tightening and weakening global demand. GDP is estimated to
have grown by 6.2% for the year as a whole. The deceleration in growth was mainly due to relatively lower growth of the agricultural and services sectors. On the demand side, the investment-to-GDP ratio has been improving and crossed the 30% mark in 2012.

In Turkey, there was a sharp slowdown in GDP growth to 3.2% in 2012 from 8.6% in 2011. There were weaker global economic conditions, especially in the crisis-affected euro zone, Turkey’s main export market; and monetary policy tightening was imposed to reverse a sharp fall in the value of the Turkish lira in late 2011 and early 2012, which had a dampening impact on the growth performance of the country. All the major sectors of the economy witnessed much lower growth rates in 2012. Moreover, gross fixed investment growth slowed sharply in 2012 due to softer domestic demand and the base effect of higher growth in 2010 and 2011. Civil war in neighbouring Syria led to an influx of refugees to Turkey. Moreover, political instability in other neighbouring countries in the Middle East is also having adverse impact on the Turkish economy.

High inflation persists

Inflation in many of these countries is supply-driven, cost-push inflation. While output is determined by demand, supply-side inefficiencies contribute to inflation. Overly aggressive monetary policy responses can also have strong output costs with limited effects on the underlying causes of inflation, as the case of India suggests. High budget deficits in most of these countries also have inflationary implications. Poor infrastructure and high relative public service costs are contributing factors. Exchange rate depreciation affecting a number of currencies in the subregion also resulted in price rises of imported commodities, including food and fuel.

The Islamic Republic of Iran and Pakistan have been experiencing double-digit rates of inflation (see figure 2.11). The persistence of high inflation in Pakistan is primarily due to entrenched expectations of inflation remaining high. It seems that the key drivers for this expectation are continued fiscal borrowings from the central bank and feared depreciation in the exchange rate even though the external current

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Figure 2.11. Inflation in selected South and South-West Asian economies, 2010-2012

![Graph showing inflation in selected South and South-West Asian economies](image)

Source: ESCAP, based on national sources.

Note: Data for 2012 are estimates. Inflation refers to the consumer price index for industrial workers in India and to Colombo for Sri Lanka.
account deficit is modest. However, inflation in Pakistan was brought down from 13.7% in 2011 to 11% in 2012. This was achieved despite increases in international oil prices, the effect of an upward adjustment in the administered prices of electricity and natural gas, supply disruptions due to heavy rains and flooding in the southern part of the country and heavy bank borrowings. Inflationary pressures in the Islamic Republic of Iran became stronger, driven by stringent economic sanctions and the removal of subsidies. With major weakening of the domestic currency, imported inflation rose. Overall inflation rose to 25.2% in 2012 and the rate is expected to remain equally strong in 2013. While economic sanctions are hurting the entire economy, people in the lower income groups are suffering the most due to high inflation and unemployment.

In India, inflationary pressures continued to remain strong. Consumer price inflation rose to 10% for the first 10 months of fiscal year 2012 as compared with 8.4% in fiscal year 2011. Food inflation has been higher than overall consumer price inflation. Food inflation was driven by higher cereal prices, unlike in the previous year when the pressure came from higher protein food prices. The persistence of high inflation in the face of the significant growth slowdown points to serious supply bottlenecks and sticky inflationary expectations. Increases in the administered price of fuel (mid-September: diesel and LPG) as a part of a reduction of subsidies also contributed to the increase in inflation. Persistent non-food manufactured products inflation, despite the growth slowdown, has emerged as a major concern. Depreciation of the rupee raised the price of imported products. Wage pressures remain persistent. Therefore, improved supply responses and moderation of wage inflation is vital for bringing down inflation to a more “comfortable” level.

In Bangladesh inflation also reached the double-digit level in 2012 when it rose to 10.6% in 2012 from 8.8% in 2011. Higher inflation in 2012 was due to multiple factors, including the lagged effect of high domestic credit growth in 2011, exchange rate depreciation and upward adjustments in energy and petroleum prices. A restrained monetary policy was used in 2012 to contain inflationary pressures and import growth. At the same time, well-targeted support programmes, such as selected rationing and fair price supply and open market sale of essentials for poor households struggling with high food prices, are being pursued by the Government. Removing critical supply bottlenecks through ongoing improvement in electricity, gas and transport infrastructure is also vital to mitigate cost-push inflation.

In Sri Lanka, inflation which was only 2.7% in February 2012 compared with that in the same month in the previous year rose to 9.9% in July 2012. Inflation for the year as a whole averaged 7.6% as compared with 6.7% in 2011. The upward revision of administered energy prices, rise in food prices due to drought conditions, depreciation of the domestic currency as well as increase in import duties on several food items contributed to upward pressure on prices. Inflation in Maldives has been on the rise and reached double-digit levels in 2011 and 2012.

Inflation in Nepal and Bhutan is closely linked to inflation in India because of the fixed exchange rates between the currencies of these countries as well as the close economic ties among them. About two thirds of the total trade of Nepal takes place with India only. Inflation in Nepal remained high but came down from 9.6% in 2011 to 8.3% in 2012. A weak supply of food items kept inflation high. At the same time, the cost of production of both agricultural and industrial products has been rising due to severe electricity shortages and rising labour wages due to increasing exports of labour. Inflation in Bhutan rose to 13.5% in 2012 from 8.3% in 2011, following high inflation in India, which supplies about three quarters of the country’s imports.

In Turkey, inflationary pressures increased sharply towards the end of 2011 when monthly inflation exceeded 9%. The exchange rate came under severe pressure at that time, resulting in tightening of monetary policy. Inflationary pressure continued throughout 2012. During the second half of the
year, the Government introduced sharp increases in indirect taxes and administered prices to shore up public finances. This raised consumer prices. Average inflation for 2012 is estimated to have been 8.9% as compared with 6.5% in 2011.

**Monetary policy needs to strike a balance between curbing inflationary expectations and reviving growth**

Countries in the subregion are facing serious challenges of slowing down of economic growth and at the same time to contain high inflationary pressures. Therefore, some countries have started to ease monetary policy to support private investment and growth. Pakistan lowered its policy rate by 150 basis points in October 2011 and again by the same magnitude in August 2012. With some slowing in inflation, the reduction in the policy rate continued in October and December 2012, when the policy rate was further lowered by 50 basis points each time to enhance the extension of credit to the private sector. In India, the cash reserve ratio of scheduled banks was lowered by 50 basis points in January 2012 and by 25 basis points each in September and October 2012 to add liquidity in the banking system and enhance the availability of credit to the private sector. Moreover, the policy rate was also cut by 50 basis points in April 2012, followed by another cut of 25 basis points in March 2013. On the other hand, Bangladesh continued tightening its monetary policy from 2011, and the policy rate was raised by 100 basis points in fiscal year 2012 to restrain inflationary pressures. Consumer credit was tightened through administrative measures. Similarly, policy rates were raised in Sri Lanka in February and April 2012 to curtail trade-related credit to reduce trade and current account deficits as well as to contain inflationary pressures. However, the policy rate was lowered by 25 basis points in December 2012 as GDP growth was decelerating sharply.

**Budget deficits continue to remain high**

Budget deficits generally remained higher in these countries compared with other subregions. The main reason for this is low tax-to-GDP ratios: for example, the ratio maintained by the central Government of India has been less than 11% in recent years (India, Ministry of Finance, 2012), and in the case of Pakistan it has been about 10% (Pakistan, State Bank of Pakistan, 2013). On the other hand, Turkey enjoys a tax-to-GDP ratio of more than 20%. At the same time, the subregion’s economies must face increased demand for fiscal expenditure for expanded social services and protection that a wealthier and more developed population will demand. In this context, given their low tax-to-GDP ratios, countries have a great potential to increase tax revenues. Furthermore, a considerable proportion of government expenditure in South and South-West Asia is absorbed by subsidies and interest payments (SRO-SSWA, 2012). The hangover from food, energy and other subsidies that impose large fiscal expenditure loads on Governments of countries in the subregion is likely to endure, as only a phased approach to their elimination is appropriate. There is also considerable potential to reengineer the existing public expenditure profile across countries to provide for a greater proportion of social expenditure. Reining in fiscal deficits during a slowdown and a period of increased volatility is particularly challenging as such actions can precipitate further slowdowns; instead such action should be pursued over the medium term. India, for example, recently announced a five-year time frame for fiscal consolidation.

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**The subregion’s economies must face increased demand for fiscal expenditure for expanded social services and protection**

The Government of Pakistan finds it difficult to contain the budget deficit, estimated at 8.5% of GDP in 2012 against 6.6% of GDP in 2011 (see figure 2.12). To contain budget deficit, Government continued its efforts to broaden the tax base and simplifying the tax structure. Efforts are underway to move towards two main taxes, i.e. income tax and sales tax. On the expenditure side, austerity measures were adopted. However, policy of not passing the entire burden of oil price increases
and electricity prices and to preserve the safety nets for the vulnerable groups, have added to government expenditures. Solving energy sector problems will help macroeconomic stability through improving GDP growth, higher revenues and less subsidy expenditures.

India also has seen a growing budget deficit in recent years. Its budget deficit rose to 5.7% of GDP in 2011 due to lower than expected tax revenue and higher than expected subsidy payments, which were a result of elevated global prices for oil and fertilizer. However, through expenditure restraint the budget deficit was brought down to 5.2% of GDP in 2012. The budget for 2013 is aimed at achieving further fiscal consolidation, and the deficit is targeted at being 4.8% of GDP. The lower budget deficit should provide space for more productive private investment as a result of lower government borrowing. This should also help in containing inflation.

In Bangladesh, the budget deficit fell slightly to 4.4% of GDP in 2012 from 4.1% in 2011. With growing tax revenues, the tax-to-GDP ratio has been rising and stood at 13% of GDP in 2012, which was higher than the 11.8% rate in 2011. Improvement in tax revenue can be attributed to reforms in tax policy and administration, including modernization and automation of tax administration, expansion of the tax net and coverage, reduction of tax exemptions and the creation of awareness among citizens about paying taxes. The debt financing strategy being pursued by the Government is to seek more concessional financing to minimize the cost of debt financing and avoid crowding out of the private sector.

The budget deficit in Sri Lanka though still high has been narrowing in recent years. It came down to 7.8% of GDP in 2011 from 8.1% of GDP in 2010. It was expected that the Government’s target for budget deficit at 6.2% of GDP in 2012 would be achieved by restraining expenditure and improving revenue collection, particularly through the strengthening of tax administration. In Maldives, the budget deficit still remains high but it was brought down to 7.5% of GDP in 2011 and 12.6% in 2012. In Nepal, with growing tax revenues, the tax-to-GDP ratio has been improving and it stood at more than 14% in 2011. The budget deficit in recent years has been about 3.5% of GDP. The budget deficit of Bhutan rose to 4.4% of GDP in 2012 from 2.3% in 2011.

Fiscal policy in the Islamic Republic of Iran is being tightened gradually as oil exports fall which consequently reduces government revenues. About 60% of the country’s total fiscal revenue originates from oil exports. In the country’s fifth five-year
development plan (2010/11–2015/16), it is envisaged that subsidies will be completely eliminated within five years, with the domestic price of energy and other commodities linked to market prices. Some major subsidies for consumers were removed but the Government tried to maintain support for industry and manufacturing as rates for electricity, water and gas increase. Consumers were provided cash transfers to compensate them for losses resulting from the withdrawal of subsidies. However, the process of removing the subsidies suffered a setback with intensification of sanctions related to the country’s nuclear programme as inflation climbed. The country operates an oil stabilization fund, which receives payments when oil revenue is higher than budgeted and vice versa.

Owing to weaker economic activity, the budget deficit in Turkey rose to 2% of GDP in 2012 from 1.4% of GDP in 2011. During the second half of the year, the Government introduced sharp increases in indirect taxes and administered prices to contain the budget deficit.

**Widening current account deficits**

On the external side, current account balances in countries of the subregion are in general deteriorating but deficits are not alarmingly high, partly due to large remittances from overseas workers (see figure 2.13). Despite depreciation of domestic currencies against the United States dollar, merchandise trade deficits are on the rise. The deteriorating current account situation has left the countries with lower reserves to fall back on in the event of additional external shocks to exports and capital inflows.

In India, imports grew much faster than exports and the current account deficit increased to 4.2% of GDP in 2011. Owing to global uncertainties, exports contracted in 2012. Weak external demand affected exports of engineering goods, gems and jewellery, textiles and petroleum products, while imports continued to remain at a high level due to high prices for crude oil, gold and silver. As a result, both the trade and current account deficits increased in 2012. Large current account deficits, despite the slowdown in economic growth, are symptomatic of demand-supply imbalances and a pointer to the urgent need to resolve supply bottlenecks. However, capital flows have been adequate to cover the current account deficit thus far.

Pakistan achieved strong export growth at 28% in 2011 and value of total merchandise exports reached $25 billion. Despite the crisis in the euro zone, a major destination for Pakistan’s exports, the country could maintain exports at nearly the same level as in the

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**Figure 2.13. Current account balance in selected South and South-West Asian economies, 2010-2012**

[Diagram showing current account balances for various countries, 2010-2012]

*Sources: ESCAP, based on national sources; and International Monetary Fund, International Financial Statistics online database. Available from http://elibrary-data.imf.org/ (accessed on 30 March 2013).*

*Note: Data for 2012 are estimates.*
previous year. This implies a marginal negative growth of exports in 2012. Imports grew by 15%, primarily due to higher volumes of oil and fertilizers being imported. Overseas workers' remittances continued to grow and crossed the $13 billion mark in 2012. The growth rate in remittances over the past two years exceeded 45% partly due to Government efforts to divert remittances from informal to formal channels. These remittances have helped in containing the current account deficit. However, due to a much larger trade deficit in 2012, the current account deficit was estimated at 2% of GDP. The balance of payments position came under pressure due to declining financial inflows and substantial external debt repayments. As a result, foreign exchange reserves decreased and the domestic currency depreciated against the United States dollar.

In Bangladesh, there was a sharp slowdown in the growth of both exports and imports in 2012 due to the euro zone crisis. Exports grew by 6.2% in 2012 compared with 39.2% in 2011, while import growth declined to 5.2% in 2012 from 41.8% in 2011. Depreciation of the taka helped offset the impact of the slowdown in major export destinations and contributed to the positive growth of exports and at the same time curbed the growth of imports. The growth of imported industrial raw materials and machinery was much higher than that of other categories; both types of these goods play an important role in maintaining higher GDP growth. Workers' remittances have been growing despite the global financial crisis. After slowing to 6% in 2011, growth in workers' remittances again picked up in 2012, rising by 10.3%. This helped in maintaining a current account surplus in 2012.

In Sri Lanka, the current account deficit has been narrowing, and foreign exchange reserves have stabilized. Both exports and imports contracted in 2012 due to the global slowdown, which helped in containing the trade deficit. Tighter monetary and credit policies slowed credit and import growth. Strong growth in workers' remittances by 16.3% helped in narrowing the current account deficit to about 5% of GDP in 2012 from 7.8% of GDP in 2011.

In Nepal, with a large merchandise trade deficit and slowdown in growth of overseas remittances, the current account balance has turned into a deficit in recent years. Bhutan has been experiencing a double-digit current account deficit, mainly due to imports related to hydropower generation. However, financing the deficit with funds from India and other development partners has been adequate. The current account deficit in Maldives continues to remain high at a double-digit level. A boost in construction activities related to the tourism sector is partly responsible for a strong growth in imports and consequently the large current account deficit.

The balance of payments position of the Islamic Republic of Iran weakened considerably owing to the tightening of economic sanctions. Export of oil slowed as a result of the falling output of both oil and gas. Both trade and current account balances turned into deficits in 2012 from a surplus position in 2011. Depreciation and volatility of the exchange rate in 2012 made management of the balance of payments more difficult.

The rapid increase in Turkey's current account deficit in recent years raises serious concern about its sustainability in the short to medium term. Driven by a credit-fuelled rise in import demand and higher oil prices, it reached 10% of GDP in 2011. The weakness of import demand and the strength of export growth in 2012 indicate rebalancing of the economy. Growth of exports to non-European Union countries remained strong. The current account deficit eased to 6.2% of GDP in 2012. However, the large structural current account deficit will remain a problem as plans to tackle it, such as reforms aimed at raising the country's domestic savings rate and promoting domestic production of intermediate goods and alternative energy, are unlikely to have an impact in the short term. The Government plans to tackle the services current account deficit problem by promoting innovation, the

Large workers’ remittances continue to grow

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domestic production of intermediate goods and the use of alternative energy sources. Turkey’s outward FDI to other countries in the subregion, particularly Bangladesh and Pakistan, is on the rise.

Future outlook and policy challenges

Despite global uncertainties and home-grown constraints faced by most countries, the growth outlook of the subregion is likely to improve moderately in 2013. The region is projected to grow by 5.1% in 2013 compared with 4.1% in 2012. The economy of India is projected to have an improved growth rate of 6.4% in 2013, helped by reform and policy measures taken in 2012 to boost investment. In Bangladesh, the Government has set an ambitious growth target of 7.2% for 2013, which will be difficult to attain given the critical infrastructure shortage, global economic uncertainties and likely political instability in an election year. It is more likely that growth may be about 6% in line with the country’s growth performance in recent years. In Sri Lanka, GDP growth is expected to improve to 6.5% in 2013 due to easing of both monetary and fiscal policies, and improved performance in all major sectors, particularly the agricultural sector which suffered a setback in 2012 due to adverse weather conditions. In Pakistan, the protracted energy crisis and weak fiscal fundamentals are the main reasons behind slow growth. Similarly, the declining trend in private investment expenditures is continuing. Without stemming the free fall in investment and addressing the challenge of chronic energy shortages, growth cannot be improved on a sustainable basis. In Pakistan, GDP growth is projected to be 3.5%.

In Turkey, GDP growth is projected to pick up slightly to 3.8% in 2013, with some loosening of monetary policy. However, a risk remains that the global economic slowdown, especially euro zone sovereign debt crises, could be deeper and more prolonged than predicted. In the Islamic Republic of Iran, severe economic sanctions along with overall declining oil production and a cut in subsidies will keep GDP growth very low in 2013.

In order to realize its development potential, the subregion will have to overcome a number of development challenges, including large concentrations of poverty and hunger, rising inequality, poor levels of human development, wide infrastructure gaps, lack of a diversified base for high value added products and exports, widespread food and energy insecurity and high risk of disasters (SRO-SSWA, 2012). In addition, the four least developed countries in the subregion, three of which are also landlocked, have particular needs for international support if they are to overcome the obstacles they face.

The subregion’s economic, social and environmental priorities must be balanced in favour of eradicating extreme poverty and hunger

The subregion’s economic, social and environmental priorities must be balanced in favour of eradicating extreme poverty and hunger. Today, South and South-West Asia remains home to the world’s largest concentrations of people living in poverty and hunger, and people without access to basic sanitation and electricity. The subregion is also characterized by having the world’s highest levels of child and maternal mortality. Progress on the health, nutrition and sanitation-related Millennium Development Goals and related targets has been stalled because of the large inequalities and disparities within populations.
that persist in the subregion. Inclusive development is held back by unequal living standards, unequal human development outcomes and unequal opportunities based on gender, education and labour market status.

The high concentration of poverty and hunger results partly from a mismatch between structural change in output and employment structure. While the share of the agricultural sector in GDP declined sharply over time, the majority of workers are still employed in this sector. As a result labour productivity in the agricultural sector remains low. The services sector is the second major provider of employment but most of these jobs are low paid and in the informal sector. Official open unemployment rates are generally low in these countries. For example, the unemployment rate was 6% in Pakistan and 4.5% in Sri Lanka in 2011. Therefore, in South Asia far more important is the persistence of low productivity and low paying jobs, which are mostly found in the agricultural and urban informal sectors. In 2010, the agricultural sector accounted for 51.4% of total employment in 2010, whereas industry and services accounted for just 20.8% and 27.9% respectively (SRO-SSWA, 2012).

Women are also far more likely to be employed in informal work than men. Despite this, women’s labour force participation rates remain relatively low at 36% compared to 77% for men. Given that labour markets are overwhelmingly informal in the subregion, and that women are more likely than men to be employed informally, efforts to protect and improve the livelihoods of informal workers may indirectly encourage more female labour force participation (SRO-SSWA, 2012).

This subregion faces the dual challenge of raising productivity to ensure that incomes are rising and poverty is falling, and creating enough jobs for a growing working-age population, which is expanding by about 2% per annum. With almost 60% of the population under the age of 30, Governments of countries in South Asia have to take advantage of this demographic bulge. Otherwise, the consequence can be social unrest, conflict and insecurity.

Youth unemployment is an increasing structural problem, and it stood at 9.9% in 2011 as compared with the 3.6% overall unemployment rate in South Asia. For some individual countries, the rates of youth unemployment were much higher, for example, more than 17% in Sri Lanka in 2010. In South Asia, demographic trends are such that the youth labour force continues to grow and few opportunities exist for paid work. Even if paid work can be found, the risk of low wage employment is substantially higher for young workers. Therefore, workplace training schemes, the creation or improvement of apprenticeship systems and entrepreneurship training programmes as well as programmes that are aimed at offsetting the mismatch of technical skills among youth are important to enhance the employability of youth.

South and South-West Asia must offer a way out of poverty and exclusion for its rapidly growing working-age population. Therefore, countries in the subregion should maximize growth through productive job creation and appropriate structural change to reduce poverty, hunger and inequalities. Countries in the subregion should also provide good-quality education, health, sanitation and other infrastructure.
Box 2.4. South Asia: demographic dividend or deficit?

The demographic challenges facing the Asia-Pacific region are as diverse as its people. In contrast to the countries of East and North-East Asia that must meet the economic constraints posed by a rapidly ageing population, the countries of South and South-West Asia are attempting to reap the potential economic benefits generated by a shift in the composition of the population structure towards youth and adults in the prime working-age group. The possibility of capitalizing on this transformation, through education and health and employment policies, for example, is what is referred to as the “demographic dividend”. The demographic dividend, then, is not an automatic phenomenon. It is a window of opportunity that needs to be opened by creating the right institutional arrangements and policy mix. If the right policy mix is not in place, however, high unemployment and underemployment may result, and education and health-care systems may endure substantial strains. In such a case, the “dividend” would become a “deficit”.

In South Asia the demographic conditions are right for achieving a demographic dividend. This subregion has been undergoing rapid demographic change during the last several decades. For instance, infant mortality rates have substantially declined from roughly 160 per 1,000 live births in the 1950s to about 60 in 2010. Total fertility rates also dropped from about 6 children per woman in the 1960s to approximately 2.8 children in 2010. Further, since 1950, life expectancy at birth has increased from less than 40 years, to 65 in 2010 (Bloom, Canning and Rosenberg, 2011). As a result of this demographic dynamic, the countries of South Asia, except for Sri Lanka, will experience a significant increase in their working-age population over the next four decades (Bloom, Canning and Sevilla, 2003). Bangladesh, India and Pakistan, the three largest countries in the subregion, exemplify this tendency. This relative increase in the younger portion of the working-age population (15-64 years) was generated during the late stages of the demographic transition when fertility rates began to fall. This transition produces a youth bulge from which a “boom” generation emerges, that is, a generation that is larger than that which precedes and follows it. Over time this generation works its way through a given country’s age structure (Bloom, Canning and Sevilla, 2003).

In Bangladesh and India a boom generation has already reached working age. In Pakistan there will be a boom generation reaching working age in the next few years. As a result, it is projected that the working-age population in the three countries

Figure A. Percentage of working-age population (15-64 years) in selected countries, 1970-2050

![Percentage of working-age population (15-64 years) in selected countries, 1970-2050](chart)
will increase during the next three decades. In Bangladesh the inflection point will be reached approximately in 2025 when a little more than 70% of the population will be of working age; and it will remain at this level for 15 years before it begins to decrease towards 2040. India and Pakistan will reach their inflection points approximately a decade later, in 2035. This phenomenon goes against the general trend in the Asia-Pacific region where most countries are projected to experience a decrease in the working-age population. The Russian Federation, for instance, reached its inflection point in 2009; and China and Thailand are expected to reach theirs in 2013 and 2014 respectively. In all three cases the proportion of the working-age population is expected to drop precipitously in the next decade (UNDESA, 2012b).

For Bangladesh, India and Pakistan to reap the demographic dividend, effective employment policies need to be developed to ensure that the growth in the workforce transfers into productive employment. These policies need to be explicitly targeted at youth. Specifically related to this issue is the problem of integrating those in vulnerable employment. In Bangladesh, India and Pakistan more than 60% of the workforce occupy jobs in the informal sector. This not only results in a vicious circle of poverty, but also represents the loss of a potential tax base that could be used to finance social protection and other pro-poverty measures. Indeed, measures to enhance the productivity of workers and formalize the labour market are essential for ensuring that these countries capitalize on their demographic dividend.

In addition, a young labour force implies innovative and entrepreneurial potential that could provide a competitive advantage in the late-modern information age and knowledge economy. This composition can provide dividends in the form of a more entrepreneurial business culture and by empowering young women. As fertility rates decrease women can break away from their traditionally ascribed roles and join the labour force. Such an increase in female labour participation would also play itself out in terms of human development and enhanced domestic demand.

In addition to effective employment policies, building human capital through investments in health and education is essential. It has long been acknowledged that health and education are central determinants of human capital, that is, of the stock of knowledge and skills that go into economic production. Good health makes people more productive while those that receive higher formal education tend to earn more money than others. Health and education therefore add value to the economy and increase a household’s income. These are necessary conditions for sustained economic development.

In addition to the potential increase arising from a larger number of workers, an increasing proportion of the working-age population also provides an opportunity to reap a demographic dividend through an accelerated accumulation of capital as a result of reduced spending on dependents. As the “boom” generation begins to enter the working-age group, the ratio of the non-working-age population to the working-age population – that is, the “dependency ratio” – will begin to decrease. If the increasing number of individuals of working age can be productively employed, a lower dependency ratio would mean that less investment should be needed to meet the needs of the youngest and oldest populations; therefore, household income, savings and economic growth will increase. Again, as with the share of the working-age population, in contrast with the general trend in the Asia-Pacific region, the dependency ratios of Bangladesh, India and Pakistan are projected to fall during the next several decades. For instance, in 2010 the dependency ratios of these three countries were 56%, 55% and 66% respectively. All exceeded the average for Asia and the Pacific of 48%. However, the three countries’ dependency ratios are projected to fall to 41%, 46% and 43% respectively by 2040, while the average in Asia and the Pacific is expected to increase to almost 52%.

In sum, with the right policy mix, the demographic dividend can be reaped, accruing from the rapid demographic transition. Otherwise, high population pressure will continue to make widespread poverty, hunger, vulnerable employment and lack of basic services a major challenge for most countries of South Asia to achieve.
to make the most of the youth bulge (see box 2.4). In addition, a minimum social protection floor should be established that meets the basic needs of vulnerable populations.

South and South-West Asia faces exponentially growing energy demand, and a number of energy challenges — energy poverty, lack of available supplies, poor energy infrastructure and transport facilities and environmental externalities. The subregion’s energy deficits are particularly detrimental in terms of growth and poverty alleviation as parts of the subregion faces regular and sustained power outages. At the same time, the subregion must increase energy usage in order to maintain growth and development. Energy security, linked with energy availability, accessibility and affordability, is a paramount policy concern for countries in the subregion. South and South-West Asia remains completely dependent upon imports of fossil fuels, except for the Islamic Republic of Iran which is a net exporter of such fuels. The subregion has much to gain from regional cooperation in energy supply and consumption. Widening access to clean and efficient energy, including grid-connected/decentralized power, is a key component of development efforts currently being pursued in the subregion. The development of energy markets in South and South-West Asia, through the creation of regional energy grids and cross-country pipelines across the subregion as a part of the proposed Asian energy highway, could assist the subregion in promoting energy access and security. Diversification of the energy mix and an increase in the share of renewable energy, such as solar and hydroelectric power, is essential to enhance the subregion’s energy security, to reduce the impact of price shocks due to fluctuations in international crude oil prices and to mitigate the environmental impact of energy use.

Strengthened regional cooperation can help solve a number of the challenges facing South and South-West Asia and can be an important development strategy to ensure a sustainable future for the subregion (SRO-SSWA, 2012). Greater regional integration not only increases intraregional trade, but also promotes efficiency-seeking investment in the subregion’s supply chain and production networks. This, in turn, creates more and better jobs in addition to building productive capacity, particularly in the subregion’s least developed countries. Regional cooperation can play a pivotal role in crafting solutions to shared vulnerabilities and helping ensure food and energy security, as well as reducing the subregion’s vulnerability to natural disasters. Finally, better connectivity, across the subregion and beyond, can help leverage the subregion’s strategic location at the crossroads of Asia and the Pacific to re-emerge as the hub of East-West trade that it once was.

SOUTH-EAST ASIA

Growth accelerates, led by robust domestic demand and Thailand’s rebound

South-East Asia as a whole achieved a high economic growth rate of 5.3% in 2012, up from 4.5% in 2011, despite weakening external demand. Growth was driven by buoyant domestic demand backed by supportive policies. Fourth quarter growth was particularly strong in several economies in the subregion. Strong economic growth over the past two decades has resulted in a growing middle class. Average annual income per capita in the subregion doubled from $2,387 in 1990 to $4,744 in 2011, while the population living below $1.25 a day (in 2005 PPP) declined from 45.5% to 14.7% during the same period. This overlapped with a decline in the share of agriculture in GDP, and a commensurate rise in the shares of industry and services. This structural transformation in turn was possible due to an educated and healthy workforce; during the past two decades, net enrolment in secondary education nearly doubled to two thirds of the population of secondary school age, while infant and under-five mortality rates were more than halved. Human capital will become increasingly important as countries in South-East Asia seek to maintain the growth momentum amid a challenging global environment.
Table 2.5. Rates of economic growth and inflation in South-East Asian economies, 2011-2013

(Percentage)

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<td>5.9</td>
<td>5.0</td>
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a Changes in consumer price index.
b Estimates.
c Forecasts (as of 30 March 2013).
d GDP figures at market prices in United States dollars in 2011 (at 2000 prices) are used as weights to calculate the subregional growth rates.

In Brunei Darussalam, which has one of the highest per capita incomes in the world, the economy grew by 1.6% in 2012, down from 2.2% in 2011, due to a drop in oil and gas output, together will a fall in liquefied natural gas (LNG) production. However, non-oil and gas sector growth rose by 4% in 2012, driven mainly by expansion in government services, the wholesale and retail trade, business services and water transport. Under the national development strategy, entitled “Vision 2035”, the Government has increased spending on tertiary education, while making a commitment to reducing the country’s high level of energy intensity and exploring alternative energy as a potential source of business and job creation. Efforts to diversify the economy are also ongoing.

Cambodia has sustained a high level of economic growth, led by garment exports. Although the economy has somewhat slowed since the global financial crisis, it expanded by a robust 7.1% in 2011 and 7.3% in 2012. Growth of garment exports slowed in 2012, after having accelerated in 2011 under the European Union’s special market access scheme. However, other drivers of growth, including tourism and construction, grew at a faster rate in 2012, while credit growth to the private sector remained high. Agricultural output also benefited from increased government support to small-scale rice farmers under a scheme to promote milled rice as a key export commodity. The economy, however, faces the challenge of diversifying and moving up the value chain from low-wage garment production. Recent protests over forcible displacements from land concessions also highlight the need for the development process to be more just and inclusive.

In Indonesia, strong and sizeable domestic demand has helped the economy to weather the global downturn more resiliently than most other regional peers. The economy expanded at 6.2% in 2012, after recording a 6.5% growth rate in 2011, the fastest pace in 14 years. The contribution of private consumption to quarterly GDP growth increased steadily over the year, underpinned by a tight labour market, stable inflation and thus consumer optimism. The contribution of gross fixed capital formation was also buoyant. The fixed investment-to-GDP ratio continued its upward trend in 2012 as a result of improved macroeconomic fundamentals, currently about a quarter of GDP. In contrast, exports of goods and services held back growth, especially in the second half of 2012 when shipments declined. On the supply side, a solid expansion in the services
sector helped to offset softer manufacturing activities. Employment growth, however, decelerated from 3.6% in 2011 to 1.4% in 2012.

The economy of the Lao People’s Democratic Republic continued to expand rapidly, driven largely by gold and copper mining and hydropower investments. The economy grew by 8.3% in 2012, at a similar pace to that in 2011. Economic growth was also supported by the rising contribution of garments and tourism, as well as a recovery in agricultural production following the floods in 2011. Public construction activities for the Asia-Europe meetings held in November 2012 also made contributions. More importantly, services such as telecommunications have seen a steady increase in recent years, in line with rising incomes and growing domestic demand. In early 2013, the country became the newest member of the World Trade Organization. Just as important as gaining better market access as a result of accession to WTO is the provision of incentives for and the anchoring of domestic reforms.

Despite its high trade exposure, Malaysia maintained a solid economic growth rate of 5.6% in 2012, up slightly from 5.1% in 2011. Domestic demand expanded robustly, offsetting poor export performance. Private consumption growth accelerated on buoyant job markets, low inflation and government initiatives, such as civil servant salary hikes and one-off cash assistance to lower-income households. Similarly, fixed investment growth surged to a multi-year high pace on public infrastructure spending and firm private investment benefiting from the ongoing structural reform agenda to achieve high-income country status by 2020 (Vision 2020). In contrast, the export of goods and services decreased from mid-2012, but much more modestly than the magnitude recorded during the peak of the global financial crisis in late 2008 and early 2009.

The economy of Myanmar is expected to expand by 6.3% in 2012, up from 5.5% in 2011. Natural gas exports and higher investment in the energy sector continued to fuel growth. The lifting of sanctions by the European Union and the United States following recent political reforms, together with domestic economic reforms, is opening up new opportunities for the economy, although large infrastructure bottlenecks and skill gaps remain to be addressed. The new foreign investment law and special economic zones are expected to help attract investment in labour-intensive manufacturing activities. At the same time, the Government has cut military spending to allow room for increased education, health and infrastructure spending, while expanding credit to the agricultural sector and rural areas. An overarching challenge is to rapidly expand electricity generation and supply; currently less than 20% of population has access to electricity.

Following a weak 3.7% economic growth rate in 2011, the Philippine economy recorded a respectable growth rate of 6.6% in 2012. The buoyant expansion was led by domestic demand, although the export of goods and services also appeared to hold up reasonably well. Steady private consumption was supported by historically low interest rates, firm employment conditions and stable inflation. Household incomes also benefited from largely resilient remittance flows, but appreciating domestic currency has somewhat reduced the value in domestic currency terms. Gross fixed capital formation increased rather solidly in line with the improving investment climate. Public consumption also stepped up, with a slightly higher share in GDP in 2012 relative to the past several years. Employment growth, however, decelerated from 2.4% in 2011 to 1.3% in 2012. Higher job creation in the formal sector remains a key challenge for inclusive growth.

The economy of Singapore decelerated markedly as a result of the waning global economy. Real output growth dipped to 1.3% in 2012 from 5.2% in 2011. On a sequential basis (quarter-on-quarter, seasonally-adjusted), growth performance receded
steadily over the year, with contractions recorded in the second half of 2012. Exports of goods and services account for more than 200% of Singapore’s GDP so the economy is more vulnerable to external demand shocks than its neighbours. As a result, weakness in the export-oriented sectors fed quickly into the rest of the economy. Private consumption growth virtually paused in the third quarter of 2012. This was also partly underpinned by a sluggish real wage growth due to high inflation.

The economy of Thailand exhibited a robust post-flood recovery in 2012, with output growth rebounding to 6.4% on reconstruction and revived business activities. The severe floods had pushed growth down to only 0.1% in 2011. There was a quick turnaround of production in domestic-oriented sectors, such as food and construction materials, but as production capacity started to pick up in the middle of 2012, the global environment sharply deteriorated and exports dipped. Thus growth in 2012 was supported mainly by domestic demand, especially private consumption. In addition to favourable employment conditions, consumer spending benefited from government schemes, such as tax relief for first-car purchases, higher minimum wage levels in key economic areas and higher salaries for civil servants with university degrees. The return of overseas tourists also contributed to the growth outcome. Replacement of damaged production facilities helped to boost fixed investment although weak export orders held back investment growth somewhat.

Under the Timor-Leste Strategic Development Plan, the Government is rapidly scaling up social spending and capital investment, with a view to develop the non-oil economy, create jobs and reduce poverty. Despite significant efforts, persistant poverty and large development gaps remain, and there is currently no domestic production base except subsistence farming and coffee, leaving the country heavily dependent on imports.

Viet Nam’s economic growth rate decelerated further to 5% in 2012, following rates of 5.9% in 2011 and 6.8% in 2010. Weak growth was partly cyclical, resulting from the need to stabilize the economy and curb inflation, but also partly structural, as side effects of heavy investment-driven growth became more visible in State enterprises and the banking sector. Industrial activity was particularly weak at the beginning of the year, but improved as the year progressed. A bright spot in the economy was the buoyant services sector, which continued to expand at a rapid rate, with tourism, hotels and restaurants growing more than 20% faster than in 2011. Continued strong agricultural production also contributed to growth. Although facing significant challenges in stabilizing the economy and restructuring the financial sector, the country possesses a dynamic workforce and a relatively diversified economy.

Inflation softens as pressure from food and fuel prices subsides

Inflation rates across the subregion softened in 2012 (see figure 2.14). In particular, food and fuel inflation moderated, although still outpacing headline inflation in most countries. This helped in lowering inflation in Indonesia and the Philippines where, despite strong domestic demand, average inflation rates were comfortably within the central banks’ target ranges. In the case of the Philippines, food prices trended upward in mid-2012 after a series of typhoons and monsoon rain that led to some supply disruptions, but downward adjustments to fuel prices held back transport inflation. In Thailand, consumer inflation moderated in 2012 as food inflation, which reached nearly 8% in 2011 as a result of flood damage, softened as agricultural production regained its former position. Similarly, Cambodia and the Lao
People’s Democratic Republic benefited from lower food and fuel inflation.

In addition, labour market and wage policies could affect inflation. In Thailand, inflation expectations could rise as the application of higher minimum wages is extended to all provinces in 2013. In Malaysia, the nationwide introduction of minimum wages in January 2013, and in July for smaller business enterprises, could add to price pressures. However, given the moderate core inflation in these countries, the concern has been more on the impact on employment rather than prices. In Singapore, where inflation remains above-trend, the Government’s efforts to enhance productivity through tightening the inflow of foreign labour could elevate labour costs, at least temporarily, and thus core inflation. In the Lao People’s Democratic Republic, it is expected that inflation will edge up in 2013 due to an across-the-board increase in public sector wages.

Another factor affecting inflation could be changed in administrated prices and taxes. In Malaysia, a government effort to rationalize fuel price subsidies continued in 2012, with the price of premium petrol having been adjusted upwards by about 11% in September. However, the inflation impact has been quite modest. The introduction of a goods and services tax could push up inflation expectations. In Indonesia, the price prospect is highly sensitive to possible changes in administrative prices; for instance, in the budget for 2013 a 15% increase in electricity prices has been proposed.

Inflation can also be induced by excessive liquidity and high government spending. Inflation in Viet Nam declined significantly from 18.7% in 2011 to 9.3% in 2012, under the Government’s effort to stabilize the economy from the side effects of earlier expansionary policies. However, inflation still remained high in health services, education and transport, leaving average households exposed to large price increases. In Singapore, price pressures have generally been fuelled by low global interest rates that drove up domestic property prices. In Timor-Leste, strong demand-side pressure from rapidly rising government spending continued.
Active fiscal policy helps boost domestic demand

Fiscal policy remained accommodative across the subregion, with several countries increasing public outlays for infrastructure. In mid-2012, the Government of Indonesia announced additional capital spending of 0.3% of GDP mainly to enhance lagging public infrastructure. The Government plans to boost infrastructure spending by 15% in 2013, although underspending has been observed in previous years. Similarly, fiscal policy was stepped up in the Philippines to sustain domestic demand dynamism, with the increased spending primarily concentrated on infrastructure projects. Initiatives on private-public partnerships, which had earlier exhibited slow progress, have benefited from increased investor confidence. In Thailand, a large-scale public investment plan for water management contributed to fiscal policy support, although the boosting impact could be lower than planned due to slow disbursement of funds. In the Lao People’s Democratic Republic, the Government established a State accumulation fund to be used in the event of natural disasters or major economic shocks. In Myanmar, the Government cut military spending from 23.5% to 14.5% of total expenditure in fiscal year 2012/13, while increasing social spending from 5.4% to 7.5%.

More active fiscal policy in 2012 resulted in manageable increases in deficit in 2012 in countries such as the Philippines and Thailand (see figure 2.15). In Indonesia, subsidies on fuel and electricity exceeded their target and contributed to a larger budget deficit. To finance the development expenditures, the Philippines is focusing on widening the tax base and efficient expenditure management. In

In Indonesia, the minimum level of taxable income was also raised to support consumer spending.

Fiscal policy was also aimed at supporting vulnerable segments of society and enhancing basic social services. In Malaysia, cash assistance was furnished to low-income families and book vouchers to students. In Singapore, schemes to support households are focused on financial assistance to elderly and disabled citizens, expanding health-care services and helping low-income families, with such means as pre-school subsidies and a larger endowment fund. In Viet Nam, the Government raised its health insurance subsidy for the poor from 50% to 70% of the premium in June 2012, as part of its efforts to achieve universal health care coverage by 2014. In Myanmar, the Government cut military spending from 23.5% to 14.5% of total expenditure in fiscal year 2012/13, while increasing social spending from 5.4% to 7.5%.

In addition to the above-mentioned demand-boosting measures, higher-income countries had greater policy space to accommodate medium-term development strategies. For instance, the Government of Malaysia announced in July 2012 a new strategic fund to facilitate technology acquisition by local firms and fiscal incentives that help Malaysian companies to acquire foreign companies to gain frontier technology. In Singapore, small and medium-sized enterprises benefited from a cash grant and training programme as well as financial incentives for firms to enhance productivity and innovation efforts. In Brunei Darussalam, the $5.2 billion budget approved in March 2012 prioritized improved human resources and government services, in line with the country’s plan to further diversify its economy.
Domestic resource mobilization remains a particular challenge for low-income countries. Despite a reduction in fiscal deficit in 2012, Cambodia’s overall tax-to-GDP ratio has remained at about 10-11% of GDP since 2008. To address this issue, the Government introduced a new strategy for revenue mobilization. The Lao People’s Democratic Republic has been more successful in raising the tax-to-GDP ratio, with non-natural resources-based revenue increasing with the introduction of value added taxes in 2010. In Myanmar, as part of the country’s ongoing economic reforms, the Government plans to simplify the commercial tax on domestic sales and enhance tax administration and capacity.

Monetary policy supports growth while curbing short-term inflows

Monetary policy was supportive of economic growth across the subregion in the light of the heightened global economic uncertainty. In particular, policy interest rates were at historically low levels. The Philippines central bank cut the overnight rate four times in 2012 to a record low level of 3.5%. In Thailand, the policy interest rate was lowered to support the recovery from a sharp, flood-related economic downturn and was further reduced to 2.75% in October 2012 as the global economic slowdown deepened. The Indonesian central bank resumed policy interest rate cuts in late 2011 and early 2012 but has since left it unchanged amid strong domestic demand; still, the level of 5.75% as of February 2013 is lower than the trough recorded during the peak of the global crisis. Unlike most peers in the subregion, Malaysia left unchanged its policy interest rate since May 2011 on resilient domestic demand, but the current level of 3% is still lower than the pre-crisis level of 3.5%.

Low interest rates translated into a double-digit growth in consumer and business loans in Indonesia and the Philippines. While the banking sector remained generally healthy, the central banks used various macroprudential measures to ensure financial stability. In the Philippines, the central bank redefined real estate activities to lessen the bank’s exposure to the sector. In Indonesia, a more stringent rule on down payments was announced in mid-2012 to slow credit growth for the purchase of housing and automobiles. Similarly in Malaysia, asset price build-ups in certain sectors have been dealt with by using macroprudential measures rather than changes in the policy rate.

At the same time, countries remained vigilant to the impact of liquidity injections in the advanced economies, in particular the pressure on exchange...
rates and asset prices. In this regard, low interest rates helped not only to sustain the growth of bank loans but also to slow potential capital inflows. Other policy measures included limiting currency forwards, imposing capital controls and promoting capital outflows. For instance, the Philippines central bank announced limits on banks’ currency forward positions and banned the overseas funds for special deposit accounts. Thailand lifted the limit on individuals making direct investments abroad, but this action has raised concern that long-term funds are being traded for short-term funds, making the country more vulnerable to a sharp capital reversal.

In the case of Singapore and Viet Nam, monetary policy remained tight in order to curb inflationary pressures. Singapore’s exchange rate-based monetary policy tightened, with the pace of appreciation increasing to restrain imported inflation. At the same time, macroprudential measures were augmented to cool down an increase in property prices, which amounted to more than 50% between 2009 and 2012. Viet Nam also maintained a generally tight monetary stance, but some of the earlier stabilization measures were relaxed, with the refinance and discount rates falling to 10% and 8% respectively by July 2012, from 15% and 13% at the end of 2011. In Viet Nam, vulnerabilities in the banking sector have emerged as a major concern. In March 2012, the Government approved a plan to buy non-performing assets from commercial banks. According to the central bank, bad debt ratios had increased from 3.1% of loans at the end of 2011 to 8.8% in September 2012. A National Assembly report in September noted that up to 300 trillion dong ($1 = 20,855 dong in September) would have to be injected into the struggling financial sector. In a government directive approved in February 2013 said that bad debt should be cut to below 3% of loans by 2015.

In the lower income countries, monetary policy continued to rely largely on regulation-based instruments. With the rapid growth of domestic credit and the opening of stock exchanges in Cambodia and the Lao People’s Democratic Republic, enhanced supervision and regulation of the financial sector have become more important. In Cambodia, the monetary authority raised the reserve requirement for banks and made a commitment to safeguarding the health of the banking system by strengthening supervisory capacity and strictly enforcing prudential regulations. In Myanmar, monetary policy is largely in its early stages of development, and financial intermediation remains weak. However, the financial sector is being gradually modernized, starting with partial liberalization of the deposit rate and the relaxing of some restrictions on private banks. In Timor-Leste, credit to the private sector has risen but remains low at only 13% of non-oil GDP, reflecting the lack of collateral, weak contract enforcement and the limited number of banks.

Current account surpluses narrow but FDI and remittances remain strong; portfolio flows volatile

Balance of payments in general remained favourable, although the impact of weakening external demand certainly was felt in the export-oriented economies of the subregion. In Singapore, a contraction in the momentum in respect of the export of goods became more visible in mid-2012. Merchandise imports also decelerated but less quickly, thus trimming the current account balance from 21.9% of GDP in 2011 to 18.6% in 2012. In Malaysia, while the export of goods slowed, import growth was relatively more resilient in 2012 primarily on a surge in fixed investment and continued inventory accumulation. The country’s current account surplus was trimmed from 11% of GDP in 2011 to 6.4% in 2012 (see figure 2.16). Thailand’s export performance gradually improved on restored export-oriented production capacity, but it was still constrained by weak export orders. Total merchandise exports expanded modestly by 5% in 2012, partly on the low base effects. While automobile exports advanced solidly, shipments of electronics and electrical products fell markedly. Agricultural exports also dipped, reflecting the lower exports of rice and generally less supportive prices.
After the start of 2013, the Thai baht appreciated sharply, partly because of increased capital inflows into short-term securities.

In Viet Nam, a small trade surplus was recorded in 2012, with export growth accelerating despite the United States and the European Union being the country’s leading export markets. In the Philippines, trade deficits narrowed on a rebound in overall exports. However, shipments of electronics items, which account for more than 40% of total exports, continued to decline at a double-digit rate for several months. Indonesia’s current account balance turned into deficit in late 2011 and further weakened in 2012 on healthy domestic demand and subdued exports. Increased fuel imports also contributed to that situation. To cope with lacklustre shipments, the Government announced measures, such as an effort to stabilise the rupiah currency and ensure access to trade finance.

At the same time, foreign direct investment into the subregion generally remained strong. In Indonesia, inflows of FDI continued to strengthen because of the country’s dynamic investment climate and growth potential. In the Philippines, inflows enjoyed a marked increase in anticipation that the country’s sovereign rating would secure investment grade status in the coming quarters. In Thailand, inflows picked up somewhat after the 2011 floods and remained largely stable afterwards. In Malaysia, inflows in 2012 were on par with the past trend, although not as strong as that in 2011. In Singapore, in line with dull export performance and orders, inflows appeared to slow. In Viet Nam, inflows in 2012 were 15.3% below 2011 levels. The government is reviewing ways to modernize the management of foreign investment inflows as part of its efforts to shift focus from quantity to the quality of investment.

Net portfolio flows exhibited a more mixed picture. In Singapore, net portfolio flows remained volatile, reflecting global swings in sentiment, but they did not substantially deviate from the past trend. In Indonesia, portfolio inflows were rather stable, even after quantitative easing. Portfolio inflows were strong in the Philippines throughout 2012 while they trended upwards in the third quarter in the case of Malaysia and Thailand.

Currencies of Malaysia, the Philippines, Singapore and Thailand strengthened through the second half of 2012 on the back of strong capital inflows. For the full year, the Philippines peso gained the most,

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**Figure 2.16. Current account balance in selected South-East Asian economies, 2010-2012**


Note: Data for 2012 are estimates.
by some 7%. After the start of 2013, the Thai baht appreciated sharply, by nearly 3% in January alone. In both countries, increased capital inflows into short-term securities were a major factor, as reflected in record stock market performance. In the case of Thailand, where Japanese investment is dominant, the yen’s depreciation also served to strengthen the baht as businesses were expected to benefit from cheaper capital imports from Japan. Bucking the trend, the Indonesian rupiah depreciated by some 8% in 2012, amid concerns over the current account deficit and the relatively shallow foreign exchange market.

Meanwhile, remittances continued to provide an important source of income from abroad. Remittance inflows to the Philippines proved rather resilient with modest growth, despite a fragile recovery in the United States, the key destination for Philippine overseas workers. In Viet Nam, remittance inflows in 2012 increased by more than 10% compared with 2011, that is, to more than $10 billion.

In the least developed countries, a pattern continued: that of high current account deficit financed by foreign direct investment and official loans. In Cambodia, the trade deficit widened in 2012, as garment exports slowed while strong investment-related imports continued. The current account deficit edged up to 10% of GDP in 2012. In the Lao People’s Democratic Republic, exports continued to benefit from high global prices of copper and gold. Foreign direct investment increased sharply, mainly for hydropower projects, covering a substantial portion of the current account deficit, which remained high at nearly 22% of GDP in 2012. In Myanmar, commodity exports and foreign investment in the energy sector have increased in recent years. The current account deficit edged up to 4% of GDP in 2012. To set the stage for broad-based economic development, the Government unified the exchange rate in 2012 and replaced the official peg with a managed float.

In Timor-Leste, the current account surplus fell from 55% of GDP in 2011 to about 43.5% in 2012, owing to lower petroleum revenue and rising imports, which have more than doubled since 2010. In Brunei Darussalam, exports continued to be driven by oil and gas, but non-oil and gas exports have seen a mild increase since 2011. Foreign direct investment is concentrated mostly in mining and quarrying activities, although the share of inflows into the wholesale and retail sector has increased sharply since 2010.

Future outlook and policy challenges

Countries in South-East Asia are expected to maintain high economic growth rates in 2013. Domestic demand is expected to remain robust despite a slight pick-up in inflation while the external sector is set to benefit from a modest improvement in global trade compared with the situation in 2012.

In addition to country-specific circumstances, an important determinant in the outlook for the subregion will be the creation of the ASEAN Economic Community

Indonesia’s economy is projected to enjoy a robust growth of 6.6% in 2013. Domestic demand should continue to be the main growth driver, as exports will likely remain sluggish. In addition to uncertainty in advanced economies, the extent of China’s slowdown and its implications for demand and the price of Indonesia’s commodity exports are important issues. Managing the volatility of capital flow will be another important factor, given the sizeable portion of local currency debt held by foreign investors. Output growth in the Philippines is projected to remain high at 6.2% in 2013, driven by strong private consumption. Poor global demand, including a slowdown in major trading partners such as China, could impede economic expansion, however. Speedy growth could materialize if progress on the public-private partnership initiative gains more momentum, helped by the upgrade of the country’s rating to investment grade status in March. The Government plans to raise infrastructure spending to 5% of GDP by 2016 from 2% in 2012.
Thailand’s economy is projected to grow by 5.3% in 2013. Private consumption should remain strong, supported by higher wages and modest inflation, although fiscal schemes, such as waived excise tax for first-car purchases, have expired. The economy-wide adjustments to a higher-wage environment could affect growth performance, especially among small and medium-sized enterprises. The outlook will also depend on how speedily the public investment plan on water management moves forward. Malaysia’s output growth is projected to slow slightly to 5% in 2013. The introduction of minimum wages, higher remuneration for civil servants, modest inflation and government schemes to support household incomes should continue to propel consumer confidence and spending. Impressive, above-trend fixed investment growth recorded in 2012 could be sustained depending on the progress made on the reform agenda. Singapore’s output growth is projected to pick up to 3% in 2013, partly on a low base. Although the global information technology industry is not anticipated to rebound forcefully, Singapore is set to gain from generally revived global trade in 2013. Domestic-oriented activities, such as the construction sector, are likely to be major growth drivers, supported by negative real interest rates.

Viet Nam’s economy is expected to regain its momentum in the second half of 2013, resulting in a slight acceleration in output growth to 5.5% in 2013. Much will depend on restoring confidence in the economy through keeping inflation in check, addressing vulnerabilities in the banking sector and restructuring less efficient State enterprises, as emphasized in the government directive approved in February 2013. Cambodia’s output growth is expected to remain high at 7% in 2013, on the back of a recovery in garment exports and continued growth in key sectors, including agriculture, tourism and construction. The Lao People’s Democratic Republic is also expected to maintain high growth of 8.1% in 2013, supported by strong mining and hydropower exports as well as increased foreign investment in the light of its accession to WTO. Myanmar is expected to achieve a high economic growth rate of 6.3% in 2013, as the impact of recent economic reforms is felt and infrastructure investment increases, albeit gradually. Timor-Leste’s output growth is also expected to remain high at 10%, on the back of increased public outlays financed by oil revenue. Brunei Darussalam’s output growth is expected to slow to 1.5%, as adjustments take place in its petroleum sector.

In addition to country-specific circumstances, an important determinant in the outlook for the subregion will be the creation of the ASEAN Economic Community (AEC), a single market and production base, by 2015. Under the AEC framework, progress is being made in tariff reductions, rules of origin and customs procedures, as well as in services liberalization in priority sectors, namely telecommunications, financial and professional business services. As highlighted in box 2.5, however, a key challenge will be to narrow the socioeconomic gaps remaining between the more developed and less developed members of ASEAN, particularly in the area of human capital, to ensure that the less developed members are also able to participate more actively in the regional production networks.

Compared with the strong economic performance of the subregion, employment growth has lagged behind, while vulnerable employment and youth unemployment remain persistently high. The encouraging news is that countries have begun to introduce and expand the coverage of social safety nets, such as health care and pension schemes.

In Indonesia, the Government has laid out eight priorities for sustainable growth, with green jobs as an overarching theme

In Indonesia and the Philippines, where the labour force is growing rapidly, employment growth slowed to 1.4% and 1.3% respectively in 2012, compared with 3.6% and 2.4% in 2011. The quality of employment is also a major concern. Informal employment as a share of non-agricultural employment was as high as 72.5% in Indonesia, 70.1% in the Philippines and 68.2% in Viet Nam, the three most populous
Box 2.5. Is human capital converging within ASEAN?

As the Association of Southeast Asian Nations (ASEAN) moves towards the formation of an economic community in 2015, an important concern is the wide socioeconomic gaps remaining between its more developed members, namely Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand (ASEAN-6), and less developed members, namely Cambodia, the Lao Peoples’ Democratic Republic, Myanmar and Viet Nam (CLMV). Despite significant income convergence that has taken place since the 1990s, convergence has been arguably slower in education, health and other measures of human development.

In particular, educational gaps are wide. Figure A shows that the literacy rate is significantly lower in Cambodia and the Lao Peoples’ Democratic Republic, at less than 75%. Public spending on education is lower in CLMV, particularly in Myanmar where it accounts for less than 1% of GDP. There is significant variation, however; Viet Nam spends more than 5%, the highest share only next to Malaysia.

A wide gap also exists in the average years of schooling. In fact, figure B shows that the gap today is wider than it was 50 years ago, not least due to a significant divergence in secondary education during the 1980s. As a result, an average worker in a CLMV country today would have 5.5 years of schooling compared with 8.4 years for his counterpart in ASEAN-6. Such a gap of three years could have a negative impact not only on the economic integration of ASEAN but also on its social and cultural harmonization.

In addition, the quality of education tends to vary, with students in some cases completing primary education without having acquired even basic literacy and numeracy skills. Given that teacher competence tends to be closely associated with student performance, the period of pre-service training required for new teachers ranges from two years in Cambodia to five years.

Figure A. Literacy rate and public spending on education as a percentage of GDP

Box 2.5. (continued)

Figure B. Average years of schooling, ASEAN-6 and CLMV countries, 1960-2010

in Thailand for primary and lower secondary education (UNESCO and UNICEF, 2012). The pupil-to-teacher ratio in CLMV countries is almost twice as high as that in ASEAN-6 countries for primary schools, while the pupil-to-book ratio in key subject areas also tends to be higher in the CLMV countries.

Investing in education

As highlighted by ESCAP (2001), human capital was a key factor in the “East Asian miracle”. Even in the 1960s when most countries were at similar stages of economic development, countries such as Malaysia, the Republic of Korea and Thailand achieved higher literacy rates and spent a higher portion of their incomes on education, compared with South Asian countries and the least developed countries in the region.

In order for CLMV countries to fully benefit from the ASEAN Economic Community in 2015, the focus on education needs to be enhanced. In particular, CLMV countries would be able to participate more actively in the regional production networks with a skilled labour force. Employer surveys often cite the shortage of skilled labour as a major constraint. Studies also show that education is an important factor in determining labour productivity. Figure C shows that labour productivity, as measured by GDP per person employed, grew faster in Viet Nam than in Cambodia since 1985. This seems to be consistent with the higher educational spending of Viet Nam (see figure A).

Given the budgetary constraints in the CLMV countries, more developed ASEAN-6 could introduce or scale up financial and technical assistance to the CLMV countries in the areas of education and training. Currently, some ASEAN-6 countries operate individual programmes, but a more systematic approach could also be considered; for instance, setting up an “ASEAN education fund”.

In addition, given the shortage of well-trained teachers in CLMV countries, an ASEAN-wide volunteer teaching programme could enable young, qualified teachers from ASEAN-6 countries be seconded to primary and secondary schools in the CLMV countries for a given period, during which the sending Governments would pay for the salaries of those teachers.

countries in South-East Asia (ILO, 2012b). The youth unemployment rate stood at 19.1% in Indonesia and 17% in the Philippines, substantially higher than the average unemployment rate. At the same time, as many as one in four youth were neither in education nor employment in Indonesia and the Philippines, with the share much higher among young women in the case of Indonesia.

The low level of social safety nets is a related challenge. According to an ILO report, public social security expenditure, including health expenditure, as a percentage of GDP was 8.4% for the world on average and 5.3% for Asia and the Pacific. The comparable figures for countries in South-East Asia were generally below the regional average: 2.4% in Cambodia; 2.3% in Indonesia; 1.3% in the Lao People’s Democratic Republic; 6.5% in Malaysia; 3.2% in the Philippines; 1.5% in Singapore; 4.7% in Thailand; and 4.9% in Viet Nam.

Countries are making progress, however. Thailand established a universal health-care scheme in 2002, and introduced pensions for the informal sector in 2011. In the Philippines, the share of the population covered by the Government-owned health insurer increased from 62% in 2010 to 85% in 2012. Indonesia passed legislation in 2011 to make health insurance universal in 2014. Both Indonesia and the Philippines have conditional cash transfer programmes for poor families. Viet Nam introduced an unemployment insurance scheme in 2009, and decided in 2012 to extend social security to half the labour force by 2020. Cambodia launched a national social protection strategy in 2011 to consolidate existing disparate schemes into a streamlined system for delivering services.

At the same time, environmental sustainability has received greater attention. Malaysia adopted its National Green Technology Policy to improve
energy efficiency and environmental conservation and promote the use of technology. The Government is furnishing a 2% interest subsidy and 60% guarantee to eligible companies. Carbon footprint labels and green procurement are also being emphasized. To monitor the impact, indicators, such as the number of green jobs, the contribution of green businesses to GDP, GHG emission by strategic sectors and spending on green technology research and development, will be used.

In Indonesia, the Government has laid out eight priorities for sustainable growth, with green jobs as an overarching theme: renewable energy; low carbon transport; energy efficient buildings; clean technology; improved waste management; improved freshwater provision; sustainable agriculture and forest management; and sustainable fisheries. The finance ministry has identified economic instruments, such as environmental tax and green budgeting, while the central bank has included environmental performance in bank credit policy.

The Government of Thailand in December 2012 approved a plan to change the automobile tax structure so that it is based on carbon emissions rather than engine size.\textsuperscript{15} Brunei Darussalam commissioned its first photovoltaic solar power plant in 2012 and is actively exploring alternative energy as a new avenue for expertise and skills which can be tapped into by businesses. These are part of the Government’s strategy to move away from the current high rate of per capita energy consumption and reduce energy intensity by 45% by 2035.

Endnotes

\textsuperscript{1} For further information on these, see China Daily, “China to reform income distribution”, 5 February 2013. Available from http://english.people.com.cn/90778/8122934.html.


\textsuperscript{3} The economies in North and Central Asia can be broadly classified into two groups based on the type of commodity dependence of their external sectors, which is typically measured by the share of export earnings of the top single commodity (or top three commodities) in total exports. The first group comprises energy exporters, namely Azerbaijan, Kazakhstan, the Russian Federation, Turkmenistan and Uzbekistan. In these countries, energy-related products are the single most important category of their exports. The other group consists of metal and mineral exporters, namely Armenia, Georgia, Kyrgyzstan and Tajikistan. The main exports of these economies are, for example, gold, aluminium and copper.

\textsuperscript{4} See UNDESA (2013) for an assessment of the economic effects of the Russian Federation’s accession to WTO.

\textsuperscript{5} Data for 2012 are on a calendar year basis. Afghanistan changed its fiscal year during 2012. Previously the fiscal year ran from 22 March to 21 March of the following year. Fiscal year 2012 as the transition year will contain only 9 months (21 March – 21 December). From 2013, the fiscal year will start from 22 December of the previous year to 21 December of the current year. For all practical purposes, from 2013, data on Afghanistan will be on a calendar year basis. This move is expected to facilitate development budget implementation by moving the last quarter during which most expenditure takes place to one with more conducive weather conditions.

\textsuperscript{6} For details, see Graham Bowley, “Potential for a mining boom splits factions in Afghanistan”, New York Times, 8 September 2012.

\textsuperscript{7} The budget deficit for 2012, excluding debt consolidation of power and food areas, works out at 5.5% of GDP. Moreover, Pakistan did not receive approximately $1.2 billion inform the Coalition Support Fund during fiscal year 2011/12 (although funds were received in August 2012); this had an effect on both external receipts as well as on the budget.

\textsuperscript{8} The figures are for fiscal years starting in April; an acceleration to 6.3% in fiscal year 2012/13, from 5.5% in fiscal year 2011/12.

\textsuperscript{9} Available from www.tls.searo.who.int/LinkFiles/Home_/NATIONAL_STRATEGIC.DEVELOPMENT_PLAN_.2011-2030.pdf.


\textsuperscript{11} See Francezka Nangoy and ID/Wahyu Sudoyo, “Indonesia’s 2012 current account deficit at $21.5 b: Minister”, Jakarta Globe, 8 January 2013. Available
12 FDI figures for Viet Nam can differ quite significantly depending on the source: official, UNCTAD or IMF. The cited figure is from the Ministry of Planning and Investment.

13 See ILO (2010c).

14 Public health spending is low in Thailand despite the universal health-care scheme because of low payments to hospitals, among other factors.

15 For details, see “Emissions-based car tax approved: range of 100g or less will be tax-free”, Bangkok Post, 19 December 2012. Available from www.bangkokpost.com/business/economics/326858/.
Macroeconomic policies in successful developing countries primarily focused on economic growth, subject to the constraint that inflation remained tolerable and that the balance of payments remained manageable. However, the breakdown of the Bretton Woods system of fixed exchange rates and the oil price shocks in the 1970s and the subsequent debt crisis in Latin America provoked a shift in macroeconomic policy and the role of the State in which managing public finances and keeping inflation under check were considered both a necessary and sufficient condition for growth and for achieving poverty reduction. However, this has led to neglect of the developmental role of macroeconomic policies.
There is clear recognition of the critical role of forward-looking macroeconomic policies in achieving inclusive and sustainable development, as well as the Millennium Development Goals, as contained in the outcome document of the United Nations Conference on Sustainable Development, entitled “The future we want”, and that of the high level plenary meeting of the General Assembly on the Millennium Development Goals. The report of the Secretary-General, entitled “Keeping the promise: a forward-looking review to promote an agreed action agenda to achieve the Millennium Development Goals by 2015”, furnishes guidelines for forward-looking macroeconomic policies. The reiteration of the basic objectives of macroeconomic policies and their design was necessitated by the three decades of neglect of the developmental role of macroeconomic policies. It had been assumed that macroeconomic stability in the sense of very low inflation (usually less than 5% in developing countries) and low budget deficits (usually less than 3%) was both a necessary and sufficient condition for growth, and that “growth is good” for achieving poverty reduction and other developmental goals. This trickle down approach with a single instrument (policy interest rate) to achieve more than one goal violates the basic policy rule, that is, there should be at least as many independent instruments as there are targets, as enunciated by Nobel Laureate Jan Tinbergen. Interestingly, according to the Chief Economist of the IMF, Olivier Blanchard, this would require a “divine coincidence”.

The present chapter provides a brief review of shifts in the macroeconomic policy paradigm. It is followed by a critical evaluation of the conventional macroeconomic policy framework vis-à-vis key features of a forward-looking macroeconomic policy framework that balances the stabilization and developmental roles of macroeconomic policies. This discussion is buttressed with examples from successful countries in Asia and the Pacific which pursued a wide array of macroeconomic policies in delivering broad-based growth and development outcomes with positive implications for employment and poverty reduction. The final section of this chapter contains a discussion of key areas that need greater public investment to ensure resilient, inclusive and sustainable development in the Asia-Pacific region.

**SHIFTS IN THE MACROECONOMIC POLICY PARADIGM**

Macroeconomic policies following the Second World War were focused on both economic growth and stability. For example, in the IMF Articles of Agreement it is stated that each member shall “endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances”. Macroeconomic policies that evolved in industrialized countries in the post-war era were aimed primarily at achieving internal and external balance. While internal balance was defined as full employment and price stability, external balance was defined in terms of “equilibrium” in the current account of the balance of payments. The maintenance of internal and external balance was believed to be conducive to economic growth.

The primary focus of macroeconomic policies was on growth subject to the constraint that inflation remained tolerable and the balance of payments remained manageable.

In successful developing countries, the primary focus of macroeconomic policies was on economic growth, subject to the constraint that inflation remained tolerable and that the balance of payments (current account) remained manageable. Such an approach enabled fiscal policy to accommodate large-scale government investment in both the physical and social infrastructure needed for a “big push” to break out from a “low-level equilibrium trap” or a vicious circle of poverty. Monetary and financial policies were calibrated to promote agriculture and small and medium sized enterprises (SMEs) and other priority sectors, through directed credits at subsidized rates. The exchange rate was used to
accelerate structural change and to promote exports so that the current account remained sustainable, and in a good number of cases, was in surplus. The closed or managed capital account not only prevented banking and financial crises but also helped widen policy space. These fiscal, monetary and exchange rate policies were supplemented by domestic savings, investment, wage, industrial and other sectoral policies aimed at enhancing the developmental role of macroeconomic policies.

Macroeconomics following the Second World War supported the “golden age”, a period of high economic growth and price stability that lasted for nearly three decades until the commodity and oil price shocks of the 1970s. In industrialized countries, active expansionary macroeconomic management delivered rapid reconstruction and prosperity underpinned by full employment and low inflation. Developing countries as a group experienced impressive economic growth and structural change in their economies. Industry was the fastest-growing sector, resulting in a rapid rise in its share in GDP in “virtually all the developing economies”, according to the first *World Development Report 1978* of the World Bank report. In reviewing the performance of developing countries over a 25-year period (1950-1975), it was noted in the same publication that:

The developing countries have grown impressively over the past twenty-five years: income per person has increased by almost 3 percent a year, with the annual growth rate accelerating from about 2 percent in the 1950s to 3.4 percent in the 1960s.... Moreover, it compares extremely favourably with growth rates achieved by the now developed countries over the period of their industrialization: income per person grew by less than 2 percent a year in most of the industrialized nations of the West over the 100 years of industrialization.... The progress made by developing countries is more impressive considering that their populations have been growing at historically unprecedented rates. During 1950-75, their total population increased at 2.4 percent a year. This is substantially faster than the population growth rates – typically about 1 percent a year – that the now developed countries had to contend with during the period of their industrialization.  

Economic conditions became difficult in the 1970s for both industrialized and developing countries with the breakdown of the Bretton Woods system of fixed exchange rates and the oil price shocks that occurred in that decade. For the first time industrialized countries faced “stagflation”, characterized by the co-existence of high unemployment and high inflation. Developing countries, which borrowed recycled petrodollars from commercial banks, faced debt crises in the 1980s when interest rates were raised sharply in the United States and the United Kingdom to control inflation. Only a few economies, most of them in East and North-East Asia, continued to grow rapidly despite high inflation and steep import bills.

The developments in the 1970s and 1980s led to the abandonment of the principle of balancing growth, full employment and price stability

The developments in the 1970s and 1980s provoked a shift in macroeconomic policy and the role of the State. Internal balance came to be confined to price stability, and full employment was no longer an integral part of the macroeconomic policy objective in the belief that once price stability is achieved the market would achieve full employment, as long as the labour market is fully flexible, and all else including growth would follow.

The paradigm shift led not only to the de facto abandonment of the principle of balancing growth, full employment and price stability that was enshrined in the Charter of the United Nations and the IMF Articles of Agreement but also to a very narrow definition of price stability – less than 3% for industrialized countries and less than 5% for developing countries. Furthermore, such quantitative targets attained the status of virtually a universal law applicable to all countries at all times, thus contradicting the IMF Articles of Agreement which
required “reasonable price stability” with due regard to country-specific circumstances.

While monetary and exchange rate policies were geared to achieve low inflation and a balance of payments target assumed to be sustainable, fiscal policy was stripped of its developmental and redistributive roles. Low budget deficits or primary surpluses were regarded as essential for keeping inflation low and the balance of payments sustainable. Therefore, Governments were advised to cut their expenditure without due regard to the composition of such expenditure. It did not matter if cuts in public expenditure meant a reduction in physical and social infrastructure, as it was assumed that the gaps would be filled by the private sector. In fact, as noted in the joint World Bank-IMF Development Committee interim report for 2006, the balance was indeed achieved by cutting public investment: “The evidence from countries that stabilized their economies by reducing their deficits indicates that countries often did so by cutting public capital formation significantly, despite its potential negative impact on growth and poverty reduction”.10

Unfortunately, the expectation that private investment would fill the gap created by cuts in public investment did not materialize. The precipitous declines in public investment since the early 1980s in both Latin America and Africa, the two regions which experienced growth slowdowns, were unmatched by commensurate increases in private infrastructure investment. In reviewing the situation, the following comment was made in an IMF report prepared in consultation with the World Bank and the Inter-American Development Bank:11

The share of public investment in GDP, and especially the share of infrastructure investment, has declined during the last three decades in a number of countries, particularly in Latin America. Since the private sector has not increased infrastructure investment as hoped for, significant infrastructure gaps have emerged in several countries. These gaps have adversely affected the growth potential of the affected countries and limited targeted improvements in social indicators.

It is also acknowledged in the report that fiscal analysis and policy, which focus on overall fiscal balance and gross public debt, may have unduly constrained the ability of countries to take advantage of increased opportunities to finance high-quality infrastructure projects. The agricultural sector suffered the most from declines in public investment, as public spending in agriculture plummeted across developing countries.12 For example, in Africa, public spending on agriculture fell from 6.4% of total public spending in 1980 to 5% in 2004; in Asia, it fell from 14.8% to 7.4%, while in Latin America it declined from 8% to 2.7% of total public spending.

Advice on tax policy by international financial institutions diminished the distributive role of fiscal policy and reduced fiscal space

In addition to cuts in expenditure, Governments were advised to remove trade taxes to accelerate globalization and reform their tax structure by reducing direct (income and corporate) taxes to encourage the private sector. They were encouraged by international financial institutions and development partners to do so by engaging them in a “beauty contest of good governance indicators”, according to which a country receives a low rank if its corporate taxes are high. Low corporate taxes were expected to encourage the private sector to fill the gap left by the retreat of the Government. In this context, it is important to keep in mind that many countries have gone out of their way to attract foreign direct investment (FDI) by providing subsidies and incentives. The introduction of indirect taxes, such as a value added tax – as is often advised by international financial institutions – was supposed to more than offset any reduction in revenue from cuts in corporate and trade taxes. But in reality, revenue to GDP ratio did not rise in most cases. This policy advice not only affected the progressivity of the tax structure and diminished fiscal policy’s distributive role, but also reduced governments’ fiscal
space to enable them to finance public investment and provide basic services. As mentioned in chapter 1, low tax-GDP ratios and public social spending significantly correlate with inequality.

In short, excessive focus on stabilization has led to neglect of the developmental role of macroeconomic policies. It also made macroeconomic policies procyclical and unable to respond to shocks; the procyclicality of macroeconomic policies exacerbated the negative output and employment impacts of external or supply shocks. Thus, the macroeconomic policy framework favoured since the 1980s has led to some undesirable consequences in developing countries: “stabilization traps” of low inflation with low or no growth, or excessive growth volatility with serious implications for poverty and economic security or the resilience of the people.

As noted earlier, the reliance on indirect tax and reductions in corporate and personal income or other direct tax reduced the progressivity of the tax structure and its ability to serve as a redistributive tool. Together with cuts in public provisioning of basic social and economic services and the introduction of the user fee principle, these measures contributed to a rise in inequality in many countries, even where there has been rapid economic growth, such as in Asian and Pacific economies. A recent report contains data showing that in most major economies the share of wages in GDP has also been declining since the early 1990s; however, the rising share of profit has not translated into increased real investment and productive job creation. Instead, growing profit has been used to fund speculative activities and unsustainable consumption (ILO, 2011d).

Many experts and organizations, including the IMF, believe that the rise in inequality contributed to the 2007-2008 financial and economic crises that evolved into the Great Recession of 2008-2009. “The crisis is the ultimate result, after a period of decades, of a shock to the relative bargaining powers over income of two groups of households, investors who account for 5% of the population, and whose bargaining power increases, and workers who account for 95% of the population” (Kumhof and Rancière, 2010).

The 2008-2009 financial and economic crises thus awakened many and has led them to rethink the macroeconomic policy paradigm, as reflected in the previously quoted report of the Secretary-General. This rethinking is also taking place within the international financial institutions, including the IMF (see box 3.1).

**Box 3.1. Rewriting the macroeconomists’ playbook in the wake of the crisis**

Before the global economic crisis, mainstream macroeconomists had largely converged on a framework for the conduct of macroeconomic policy. The framework was elegant and conceptually simple. Caricaturing just a bit, it went like this:

The essential goal of monetary policy was low and stable inflation. The best way to achieve it was to follow an interest rate rule. If designed right, the rule was not only credible, but delivered stable inflation and ensured that output was as close as it could be to its potential.

This was achieved by setting the key policy rate that then affected the term structure of interest rates and asset prices, and then to aggregate demand. One could safely ignore most of the details of financial intermediation. Financial regulation was outside the macroeconomic policy framework.

On currencies, countries could set an inflation target and float, or instead choose a hard currency peg or join common currency areas. In general, in a world in which central banks followed inflation targeting, there was no particular reason to worry about the level of the exchange rate or the current account balance. Certainly, attempting to control exchange rates through capital controls was undesirable. And multilateral coordination was not required.
Fiscal policy had a limited role at best, at least in the short run. With the right use of monetary policy, it was not really needed. Automatic stabilizers, such as unemployment benefits, would kick in during downturns, but discretionary policy was more likely to be misused than used well. The focus had to be on the medium run, and on fiscal sustainability.

These were simple principles, and they seemed to work. From the early 1980s on, macroeconomic fluctuations were increasingly muted, and the period became known as the “Great Moderation”. Then the crisis came. If nothing else, it forces us to do a wholesale re-examination of those principles.

Source: Extracted from Blanchard (2011a). See also Blanchard and others (2012).

NEED TO BRING BACK THE BALANCE: STABILIZATION IS NECESSARY BUT NOT SUFFICIENT

Since the inflationary episode of the 1970s and the Latin American debt crisis in the 1980s, the focus of policymakers has turned to public debt and inflation. The level of public debt is receiving heightened attention as the euro zone countries struggle to consolidate their fiscal position, pushing their economies into a double-dip recession, while the hackling among politicians over the public debt in the United States continues.

Contrary to a widely held view that high public debt causes macroeconomic instability, an influential study by IMF that was used as a justification for fiscal consolidation showed no correlation between the two (see box 3.2).

Box 3.2. Weak empirical evidence supporting conventional macroeconomic policies

The correlation between inflation and growth for inflation rates of up to about 20% is zero or a mildly positive, which is consistent with the findings of previous studies (Bruno and Easterly, 1998; Friedman, 1973). After rigorous econometric testing of the hypothesis that inflation is harmful for growth, former World Bank economists, Bruno and Easterly concluded: “The ratio of fervent beliefs to tangible evidence seems unusually high on this topic” (p. 3 of their paper). Nobel Laureate Friedman
observed that “historically, all possible combinations have occurred: inflation with and without [economic] development, no inflation with and without [economic] development” (p. 41 in his book).

Similar is the case for the relationship between public debt and macroeconomic instability. The mild positive relationship is driven by outliers. In fact, there is no optimum debt-GDP ratio. A debt-to-GDP ratio of 60% is quite often noted as a prudential limit for developed countries, which suggests that crossing this limit will threaten fiscal sustainability. For developing and emerging economies, 40% is the suggested debt-to-GDP ratio that should not be breached on a long-term basis.

The 60% figure was one of a handful of targets that European Governments set at the start of the 1990s to prepare for economic and monetary union and the eventual formation of the euro zone. There was no hint of optimality: this level was simply the median debt-to-GDP ratio. Jonathan D. Ostry and others writing on “Fiscal space” in an IMF note (SPN/10/11, September 2010) emphasized that the debt limit found in their research “is not an absolute and immutable barrier .... Nor should the limit be interpreted as being the optimal level of public debt”. According to this IMF study by Ostry and others of 23 advanced countries, the estimated debt limits, using the historical interest-rate-growth-rate differential, ranged from about 150% to 260% of GDP, with the median being 192%. In the study it was assumed that interest-rate-growth-rate differentials were generally projected to be less favourable than the historical experience. It was found that the corresponding median long-run debt ratio was 63% of GDP and the median maximum debt ratio 183% of GDP.

In the 2012 IMF publication, entitled *World Economic Outlook: Coping with High Debt and Sluggish Growth*, it is clearly acknowledged that debt thresholds are not robust: “(T)here is no simple relationship between debt and growth. In fact, our … analysis emphasizes that there are many factors that matter for a country’s growth and debt performance. Moreover, there is no single threshold for debt ratios that can delineate the ‘bad’ from the ‘good’.” (p. 109).

However, there should be some distinction between domestic and external debts. Countries should be more cautious about external debts due to additional risk of exchange rate changes. In the IMF paper entitled “Assessing sustainability” (28 May 2002), it is noted that “...an external debt ratio of about 40 percent provides a useful benchmark” (p. 25). In interpreting this benchmark, the authors of the report quickly added an important caveat: “… it bears emphasizing that a debt ratio above 40 percent of GDP by no means necessarily implies a crisis – indeed, … there is an 80 percent probability of not having a crisis (even when the debt ratio exceeds 40 percent of GDP).”

The above discussion does not provide a reason for deliberately creating high inflation or high debt or deficit through irresponsible macroeconomic policies. Instead, it highlights the need for achieving a balance between the stabilization and development roles of macroeconomic policies. Monetary expansion to support productive investment may not cause inflation in the long-run, and moderate inflation enhances fiscal space. The sustainability of a fiscal deficit itself depends on the productivity of public expenditure. An explicit focus on the composition of public expenditure and their growth effects would enable both stabilization and growth objectives to be addressed in more sustainable ways. Therefore, there should be a fuller consideration of the growth effects of various kinds of government expenditure in designing fiscal policy.
**Fiscal policy: composition of government expenditure does matter**

Although aggregate budget deficit or public debt can serve as a useful indicator of short-term macroeconomic stability, they offer little indication of their longer-term effects on economic growth which ultimately determines debt sustainability (see box 3.3). For the purpose of development, what matters is where the deficit is being spent. Is it, for example, being spent for enhancing human, physical or social capital that would improve productivity and hence growth? If that is the case then public debt, even though it rises in the short term, would be sustainable.

A Government’s budget should repair itself through the ups and downs of business cycles (Matthews, 1968). United States President Franklin D. Roosevelt in his 1936 budget message noted that “the deficit of today … is making possible the surplus of tomorrow”. Evsey Domar in the mid-1940s showed that economic growth is not neutral of the level and composition of government expenditure. He noted: “The other relevant fact – that deficit financing may have some effect on income – has received a different treatment. Opponents of deficit financing often disregard it completely, or imply, without any proof, that income will not rise as fast as the debt…. But there is something inherently odd about an economy with a continuous stream of investment expenditures and a stationary national income” (Domar, 1944).

As noted previously, in many developing countries the fiscal position was stabilized by cutting public investment to the detriment of development. However, historically public investment played a significant role in structural transformation not only of Asia-Pacific economies, but also elsewhere, as observed by the World Bank’s Commission on Growth and Development (Commission on Growth and Development, 2008):

...Strong, enduring growth requires high rates of investment. By investing resources, rather than consuming them, economies make a trade-off between present and future standards of living. That trade-off is quite steep. If the sustained, high-growth cases are any guide,

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**Box 3.3. Designing fiscal policy for growth and development**

In a development context, fiscal policy serves both as an instrument of macroeconomic stabilization and as an instrument to achieve growth and poverty reduction objectives. In many developing countries, however, the challenge of high deficits, rising debt and bouts of inflation in the 1980s and 1990s led to fiscal policy focusing largely on the goal of stabilization. Correspondingly, growth and poverty reduction objectives were underemphasized.

...Although stability is necessary for growth, it is not sufficient. The design of fiscal policy needs to identify and also incorporate the transmission channels through which fiscal policy influences long-term growth. This requires that attention be focused on the likely growth effects of the level, composition and efficiency of public spending and taxation. Fiscal policy that neglects these effects runs the risk of achieving stability while potentially undermining long-term growth and poverty reduction.

...The fiscal deficit is a useful indicator for purposes of stabilization and for controlling the growth of government liabilities, but it offers little indication of longer term effects on government assets or on economic growth. Conceptually, the long-term impact is better captured by examining the impact of fiscal policy on government net worth. “[T]here is clearly a need for fiscal policy to incorporate, as best as possible, the likely impact of the level and composition of expenditure and taxation on long-term growth while also maintaining a focus on indicators essential for economic stabilization.

*Source: Extracted from World Bank (2006).*
it appears that overall investment rates of 25 percent of GDP or above are needed, counting both public and private expenditures. They often invested at least another 7-8 percent of GDP in education, training, and health (also counting public and private spending), although this is not treated as investment in the national accounts.

Public investment in developing countries is crucial to ensure investment in infrastructural areas characterized by lumpy investments, long gestation lags and relatively lower profits, all of which make the private sector unwilling to enter these areas. Moreover, unless these infrastructural gaps are closed, the process of growth can run up against a number of constraints, such as inadequate roads, shipping capacity and air transportation, power shortages and poor communication. In the early phase of structural transformation of the successful East and South-East Asian economies, Governments also invested in several basic industries, such as steel, machine tools and basic chemicals, all of which have characteristics similar to infrastructure due to their crowding-in effect and high linkages with other activities even though they produce tradables. Public investments in these infrastructures were essential to "crowd-in" private investment.

As with public investment on infrastructure, health and education, expenditure on social security also has a positive growth effect. For example, using cross-country data for a sample of 61 countries and panel data for a sample of 20 industrialized countries, one study finds that there is a robust positive association between social security expenditure and economic growth (Bellettini and Ceroni, 2000). The empirical results seem to indicate that social security spending has a positive influence on human capital formation, which in turn has a positive effect on economic growth.

Furthermore, a system of social security enables people to become insured against risks which the private sector finds difficult to pool and manage, such as sickness and unemployment. Such insurance enables individuals to take more risks in their economic behaviour. Assuming that there is a positive relationship between the riskiness of a project and its expected rate of return, the insurance afforded by social protection may foster growth.

A number of additional considerations suggest that social protection can be good for economic growth. For example, social protection may lead to a more cohesive society that is better able to take "difficult"
political and economic decisions, thus promoting structural transformation. Social protection also prevents a group or class of society from falling so far behind the “mainstream” that the group is unable to participate in the market economy, causing a permanent loss of potential output (Arjona, Ladaique and Pearson, 2002).

In a more recent econometric study of 10 Asian developing countries, namely Bangladesh, India, Indonesia, Malaysia, Pakistan, the Philippines, the Republic of Korea, Singapore, Sri Lanka and Thailand, it is suggested that a long-run dynamic relationship exists between expenditures on education, health and social security welfare and economic growth. Such social expenditures enhance productivity by providing infrastructure, education and health, and by harmonizing private and social interests. As a result, the composition of public expenditures can play an important role in promoting economic growth. The authors concluded by noting that “fiscal adjustment that reduces unproductive expenditures and protects expenditures in (the) social sector has proved to be more sustainable and more likely to result in faster growth” (Alam, Sultana and Butt, 2010).

Therefore, there should be more scrutiny of the composition of government expenditure, instead of overall deficits or debts. Closer examination of government expenditure of the countries that are suffering from high and unsustainable debt now shows that these countries in the past had either spent on unproductive sectors, including defence, or failed to collect enough revenue when the economy was growing. This is also true in the Asia-Pacific region. For example, the public debt problem of India in the 1980s, which culminated in its balance of payments crisis of 1991, was primarily due to its inability to raise revenue, despite improvements in growth rates (5.8% during the period 1981-1990 compared with −5.2% in 1979/80). “In the early 1980s, there was actually a revenue surplus for the states, and for the consolidated accounts of the centre and the states. Both deteriorated sharply through the 1980s. India has one of the lowest levels of … tax/GDP ratio in the world. This low tax/GDP ratio has been a central feature of India’s fiscal problem” (India, Ministry of Finance, 2004).

The fact that the composition of government expenditure matters has implications for national income accounting. Since expenditures on education, health and social security expenditure contribute to the formation of human and social capital which, in turn, contributes to economic growth, they should not be treated as government consumption. Instead, they should be accounted as public investment.

Governments can also use public procurements to direct production and consumption towards greener and more labour-intensive production activities.

The role of public investment has become critical for transiting to a green economy and achieving food security through sustainable agriculture in the context of the ongoing global economic recession and high volatility of food prices. Following years of access to easy credit and overinvestment prior to the crisis, many countries now face underutilized overcapacity in most of the profitable economic sectors; hence, the private sector is understandably reluctant to make investments, a situation which is holding back recovery. In this context, front-loading massive public investments are needed in such areas as renewable energy and smallholder food agriculture to induce complementary private investments in sectors previously lacking private sector interest and to accelerate economic recovery and job creation while addressing sustainable development, disaster management, climate change and food security challenges.

Governments can also use public procurements to direct production and consumption towards greener and more labour-intensive production activities. Procurement expenditures of the Government are a significant source of aggregate demand in Asia and the Pacific. For a sample of 19 countries, including Australia, China, India, Japan, New Zealand and the Russian Federation, the total amounted to $582 billion in 2010.
Governments in Asia and the Pacific allocated 18.6% of their total expenses to procurement in 2010, a proportion which lies between the corresponding figures for the countries in the European Union (13.8%) and for those in North America (22.1%). Moreover, several countries spent a larger share of their government expenses in procurement that year, ranging from 28.2% for New Zealand to 43% for Kazakhstan. Procurement spending by Governments in countries in Asia and the Pacific tends to be centralized. The median value of the share of the central governments’ procurement expenses in the general government (at all levels) procurement expenses was 77.4% in 2010 (see figure 3.1).

With such large expenditures on procurement, Asia-Pacific economies can leverage the private sector to move towards greener and more labour-intensive production activities. This can be an important instrument of fiscal policy for inclusive and sustainable development.

**Monetary policy: moderate inflation can help economic growth**

Policymakers have long been led to believe that they must target inflation at a low single-digit level, preferably below 5%. However, there is little empirical support for such a policy prescription (see box 3.2).

In fact, a large number of studies have shown that the relationship between inflation and economic growth is non-linear: it is positive up to a moderate level and negative thereafter. The threshold level beyond which inflation adversely affects growth varies between 5% and 18% depending on the level of development of a country. The threshold is found to be higher for countries at an early stage of development. For example, the Republic of Korea grew by 8% in the 1960s and 1970s when the inflation rates were at double-digit levels. The same was true for Indonesia in the 1970s, when the economy grew by 7.7% while the inflation rate was more than 17% (see table 3.1).

High inflation also did not affect poverty reduction. For example, the poverty rate in Indonesia declined from more than 60% in the early 1970s to about 11% just before the Asian financial crisis began in 1997. Of course, the poverty rate shot up immediately after the crisis when inflation rose to 60% and the economy contracted by close to 14%.

The impact of inflation on poverty depends on a number of factors. First, although inflation may reduce the real wage, that reduction should encourage firms to expand employment. The net effect of inflation on poverty thus depends on the relative elasticities of the real wage and employment with respect to

Sources: IMF, Government Financial Statistics; and World Bank, World Development Indicators.

Note: All data are for 2010, with the exception of those for Bangladesh (2009), Bhutan (2009), India (2009), Indonesia (2004), the Islamic Republic of Iran (2008) and Tajikistan (2004).
Table 3.1. Average annual real GDP growth and inflation rates, 1950-2010

(Percentage)

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<tr>
<th>Decade</th>
<th>Indonesia</th>
<th>Republic of Korea</th>
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<tr>
<td></td>
<td>Growth</td>
<td>Inflation</td>
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<tr>
<td>1950-1959</td>
<td>4.1</td>
<td>22.4</td>
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<tr>
<td>1960-1969</td>
<td>3.5</td>
<td>196.0</td>
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<tr>
<td>1970-1979</td>
<td>7.7</td>
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<td>1980-1989</td>
<td>4.8</td>
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<td>1990-1997&lt;sup&gt;a&lt;/sup&gt;</td>
<td>6.9</td>
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<td>2000-2010</td>
<td>5.2</td>
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Note: Output growth and inflation rates for the Republic of Korea in the 1950s are average annual rates for the period 1954-1959, excluding the period of hostilities (1950-1953), and are based on real GNP and the wholesale price index.

<sup>a</sup> The years of the Asian crisis have been excluded from the time period covering the 1990s.

inflation. One IMF study found that the inflation elasticity of the income (real wage) of the poor was only 0.03, while the output (employment) elasticity was 0.94 (Ghura,. Leite and Tsangarides, 1992); in other words, a 1% increase in inflation causes the real wage to decline by 0.03% and employment to increase by 0.94%. These estimates are similar to those found by Romer and Romer (1999), implying that moderate inflation may actually reduce poverty.\(^4\)

Second, most of the poor are net debtors and should benefit from inflation if it lowers the real value of their debt. Third, what matter for the poor are the prices of essential commodities that dominate their consumption basket. Although monetary policy aimed at controlling the general price level could moderate price rises of essential commodities, the poor may be hurt if such policy causes job losses. In general, it is the unskilled workers at the lower end of the

Figure 3.2. Inflation and growth in selected Asia-Pacific countries, 1961-2010

Sources: World Bank, World Development Indicators (various issues); and IMF, World Economic Outlook (various issues).

Note: Pooled annual observations based on 25 countries in Asia and the Pacific. The countries are Bangladesh, Bhutan, Cambodia, China, Fiji, India, Indonesia, Kazakhstan, Kyrgyzstan, the Lao People’s Democratic Republic, Malaysia, Maldives, Mongolia, Nepal, Pakistan, Papua New Guinea, the Philippines, Samoa, Solomon Islands, Sri Lanka, Tajikistan, Thailand, Turkmenistan, Uzbekistan and Viet Nam.
labour market who lose their jobs first. If the main goal is to protect the poor from inflation, a better policy would be to ensure the affordability of essential goods and services through public provisioning.

Figure 3.2 shows the average rates of economic growth over the period 1961-2010 for a sample of 25 Asia-Pacific countries grouped according to their average inflation rates during the period. Interestingly, the average growth rate was higher, at 6.2%, in countries with inflation exceeding 20%, compared with 5.5% in countries with inflation rates between 0% and 5%. Examples of Asia-Pacific developing countries that grew at rates exceeding 5% amid relatively high inflation include Indonesia, Kyrgyzstan, the Lao People’s Democratic Republic, Mongolia, Sri Lanka, Tajikistan and Uzbekistan.

**Targeting inflation at a very low level can constrain growth**

In a background econometric study of Asia-Pacific countries prepared for the present issue of the *Survey*, it was found that the threshold level beyond which inflation can be harmful for growth varies between 13 and 17% depending on estimation method and model (Muzaffar and Junankar, 2012).\(^\text{15}\) It was also found in the study that the threshold level is higher in agriculture-based countries (13.5% versus 11%), countries with less financial deepening (14% versus 8%) and less open countries (11% versus 8%) (see table 3.2).

Therefore, targeting inflation at a very low level or below 5% can constrain growth, especially when it is done by keeping the policy interest rate high, because it deters investment. This is an important consideration given the fact that World Bank’s Enterprise Surveys show that “access to finance” is among the top-5 business impediments for 93% of the countries in Asia and the Pacific. Access to finance is critical for small and medium-sized enterprises (SMEs), as well as for agriculture, as those enterprises depend solely on the banking sector for external financing.

In sum, monetary tightening to tackle inflation caused by supply shocks or rising food and fuel prices exacerbates adverse impacts on growth and employment. On the other hand, moderate inflation helps keep real interest rates low and hence boosts investment. Moderate inflation also expands fiscal space through inflation tax or seignorage\(^\text{16}\) and lower interest payments on debt.

**Financial policy: prudential regulation and financial inclusion**

Historically, central banks have played an important role in development by easing the constraint of access to credit for firms through credit allocation policies (see boxes 3.4 and 3.5). For example, subsidized bank loans (known as “policy loans”) were a vital instrument for the implementation of the strategy of the Republic of Korea for

### Table 3.2. Thresholds beyond which inflation is harmful for growth

<table>
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<tr>
<th>Econometric model specifications</th>
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<th>Economic characteristics</th>
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<td>Full model</td>
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<td>Dynamic</td>
<td>10.6-12.9</td>
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<td>Excluding East Asia</td>
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<td>Financial deepening</td>
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<td>More</td>
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<td>Excluding South Asia</td>
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<td>More</td>
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<td>Less</td>
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<td>Excluding transition economies</td>
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The Bangladesh Bank is mandated by its charter to promote and maintain a high level of output, employment and real income, fostering growth and development of the country’s productive resources, besides preserving monetary and financial stability. While remaining ever watchful about preserving stability, the bank has also remained proactive in its mandated developmental role, with its monetary and credit policy stance supporting attainment of the Government’s inclusive growth and poverty reduction goals based on national aspirations and global visions, such as the Millennium Development Goals.

In recent years, Bangladesh Bank has brought about deeper engagement of the country’s financial sector in this developmental role by implementing a social responsibility-driven financial-inclusion drive in a manner that reinforces rather than impairs stability and by simultaneously stimulating incremental output and demand generated by new employment and income. To promote and facilitate the financial-inclusion drive, the bank has taken up comprehensive reform and upgrading of the country’s financial market infrastructure, including, inter alia, the setting up of a fully automated nationwide online clearing and settlement system, and by hastening automation in banks and appropriate regulatory and supervisory regimes for effective oversight of risk management, internal controls and customer interest protection for the new customer segments acquired in financial-inclusion drives.

Incentives such as modest refinance lines from Bangladesh Bank and limited interest subsidies from the Government’s budget have been made available where necessary to promote lending to smallholders/tenant farmers and SMEs. All banks operating in Bangladesh, local and foreign, private and State-owned, have come forward enthusiastically in the financial-inclusion drive, reaching out to new customer segments. They have done so with new branches and new cost-effective service delivery modes through locally active microfinance institutions and off-branch mobile telephone/smart card-based arrangements using area agents in local communities. State-owned banks have achieved a major breakthrough into a new customer base by opening about 10 million new bank accounts for smallholder farmers and other rural and urban people of limited means. This is done free of charge and with nominal initial deposits as low as Taka 10 (about 12 United States cents). They also have enabled direct delivery of agricultural input subsidies and social safety net payments from the Government into these accounts, besides conducting the usual savings and payment transactions. Moreover, the financial-inclusion campaign promoting socially responsible financing and the bank’s green banking initiatives promoting environmentally responsible financing have also been embraced with warm enthusiasm by the banking sector of Bangladesh.


promoting heavy and chemical industries. In India, a decisive shift in credit deployment in favour of the agricultural sector took place in the 1970s and 1980s. From an extremely low level at the time of bank nationalization, the credit share of the sector had moved to nearly 11% in the mid-1970s and to a peak of about 18% at the end of the 1980s which was the official target. This change played an important role in the increase of agricultural output in India.

The situation changed in India during the era of financial sector deregulation starting in 1991. The rollback of directed credit by specialized financial institutions has led to the exclusion of most farmers and SMEs from the network of formal credit. Moreover, under the pressure of trying to make banks profitable by the short-term criteria of volatile stock markets, a huge wave of bank mergers was unleashed. There is a considerable body of work showing that this action led to further exclusion of SMEs and small borrowers from formal credit markets (e.g., Bagchi and Dymski, 2007 and Chandrasekhar and Pal, 2006).

Central banks can also play an important role in development by reducing entry barriers and promoting financial inclusion through changes to the
Box 3.5. Unorthodox policies and structural change in Asia and the Pacific: the experience of Singapore and the Republic of Korea

Singapore’s policies on compulsory savings and wages to foster inclusive growth and induce industrial upgrading

While the remarkable performance of Singapore in achieving high development outcomes for its population is well known, less appreciated is the notably unorthodox policies applied by the Government to do so. These policies involved a strong role for policymakers in intervening in myriad areas of governance in order to direct development towards achieving societal goals.

A key policy approach was mobilizing domestic resources for enormous infrastructure requirements to jumpstart development. This was done through the use of the Central Provident Fund (CPF), a system of mandated saving of a substantial portion of the monthly income of employees supplemented by a similar contribution by employers and deposited with the Government. The Fund could only be used by employees on retirement, or for a number of limited uses during their working years, particularly to purchase housing and to meet health-care needs. The Fund therefore serves to address multiple challenges for the Government. It enables social security to be fully funded, as funds available for health care and retirement move up in tandem with increase in the workforce and it provides workers with the funds to become homeowners. CPF contributions could also be adjusted as an inflation fighting tool at a time of high growth and indeed contributions were increased steadily between 1970 and 1984 to reach a maximum of 50% of salary and lowered to 30% after the Asian financial crisis of 1997. Crucially, the Government as steward of the Fund could benefit from an immediate stock of money to spend on funding government projects while repayment would be significantly further down the line upon the retirement of employees.

The CPF system enables the Government to pursue one of its major policies, that is, making homeowners of the great majority of citizens. A massive programme of public housing was designed under the aegis of the Housing Development Board. Home ownership was viewed by the Government as also addressing a number of key challenges for the country. One was to create for citizens a sense of ownership towards their country, thus motivating them to contribute to the development of Singapore. Another objective was to provide a massive new source of employment in the country through the construction sector, at a time when the country was yet to benefit from significant foreign investment.

The impact of the policies was enormous in size and their effects on the economy and society. At the height of the construction programme, the Board was building a new apartment every eight minutes. Currently, about 82% of Singaporeans live in Board apartments, compared with only 9% in 1960. The country now has the highest rate of home ownership in the world. CPF continues to provide an enormous stock of funds to meet the social security requirements of the population, with current funds in members’ accounts standing at close to 200 billion Singapore dollars (S$) (US$ 1 = S$ 1.25).

One of the key macroeconomic interventions of Governments lay in maximizing the potential of domestic investment to power industrial change. Measures used include directing credit to priority sectors and maintaining caps on interest rates to foster borrowing. Maintenance of moderately below-market interest rates fostered investment without greatly suppressing savings as interest rates remained positive in real terms. Singapore has directed funds to particular industries through government institutions managing national savings. The efficiency of directed credit was ensured through the basing of loans on strict performance criteria. Another policy tool which played an important role was the institution of “wages policy”. Since the late 1970s, Singapore attempted to remove the incentive to engage in low labour productivity activities by mandating higher wages for workers. Although the policy was moderated after some years following the growth recession in 1985, it may be argued that such a policy did provide a powerful incentive for restructuring the economy. Wage policy not only spurred industrial restructuring, but also together with the CPF policy served as an important tool of macroeconomic management.
**Republic of Korea’s forward-looking investments in infrastructure, human resource and research and development**

Gyeongbu Expressway is today regarded by many in the Republic of Korea as one of the most important earlier components in the country’s industrialization. When the road linking the country’s major population centres was planned in 1967, however, national income was about $140 a person a year. According to the Korean authorities, the World Bank and other donors refused to finance its construction, regarding the highway as an excessively grandiose project for a country so poor.\(^a\) Regardless, the Government started construction of the 416-km expressway in 1968 and completed it in 1970, using a significant portion of the national budget supplemented with reparations from Japan. The expressway not only spurred economic activities along the corridor of two major population centres, its construction was a critical learning opportunity for people of the Republic of Korea. With the gained capacity, construction companies from the Republic of Korea were able to win major infrastructure projects in the Middle-East, which was a critical source of foreign exchange. Today, the Republic of Korea is regarded as leader in infrastructure construction and in 2012, overseas construction orders granted to companies in the Republic of Korea exceeded $500 billion.

The Government made deliberate efforts to upgrade the industrial structure by promoting heavy and chemical industries (HCI). It suspected that export-led growth would not be sustained when light industries’ production reached a certain level; the heavy and chemical industries drive was also largely motivated by national security concerns. HCIs were not immediately successful however and struggled during the major oil price shocks, but eventually became the backbone of the Republic of Korea’s industrialization through the 1970s and 1980s.

To finance the huge capital investments required, the Government guaranteed the reimbursement of all foreign loans and normalized relations with Japan to facilitate large inflows of capital and technology. Commercial foreign loans were mostly allocated to the manufacturing industries while public loans went to infrastructure. The National Investment Fund, established in 1973, also facilitated the financing of long-term investment in plants and equipment and provided sizeable loans to the electric power industry. In addition, tax privileges were granted to heavy and chemical industries through an amendment of the Regulation Law on Tax Reduction and Exemption in 1975.

Along with massive credit supports, the Government overhauled the country’s education and training systems to promote and secure engineers and skilled workers for heavy and chemical industries. Training centres, technical high schools and engineering colleges and universities were expanded both in quality and quantity. The Government imposed vocational training requirements on private sector firms to expand the supply of skilled labour and introduced a skills-licensing system to encourage every worker to possess at least one skill.

In addition, the Government recruited Korean scientists abroad and established a modern laboratory where research on improvement of production technologies was conducted in collaboration with industry researchers and university professors. The Korea Advanced Institute of Science and Technology (KAIST), established in 1971, and other public research institutes helped greatly advance the country’s technological capabilities. As the Republic of Korea became more advanced, private sector firms began to establish in-house research and development centres in the mid-1980s.

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\(^a\) Mr. Kim Chung-yum, the Korean Minister of Finance in the 1960s, recalled in his memoirs: “Initially, the IBRD was reluctant to provide loans, expressing scepticism, even criticism, to a developing country like Korea to build expressways. This point was made clear by the remarks of Eugene Black, the President of the IBRD, who criticized developing countries for seeking to build expressways and steel factories in the late 1950s by likening it to monument building. … After Korea showed it was able to build the Seoul-Busan Expressway with its own financial and technological resources at half the time and a fraction of the cost, the IBRD began to rethink the economic feasibility of expressways in Korea” (Kim, 2011, p. 312).
A regulatory framework to encourage banks to extend financial services to the poor and marginalized (see box 3.4). A growing body of research shows that financial inclusion can have significant beneficial effects for individuals and the economy as a whole. For example, lack of access to financial resources can lead to poverty traps, negative effects on social and human development, and a rise in inequality whereas providing individuals with access to savings instruments increases savings, productive investment, consumption and female empowerment.\(^{18}\)

**Exchange rates: an instrument for structural change**

Exchange rates have both microeconomic and macroeconomic roles. As a relative price,\(^{19}\) exchange rates play an important microeconomic function in terms of structural change between tradable and non-tradable sectors of an economy and in maintaining international competitiveness. Owing to the close association between balance of payments outcomes and budget deficits and monetary policy stance, exchange rates can also function as an important macroeconomic policy tool. It is believed that exchange rate regimes can impose discipline on the macroeconomic policy mix, especially by constraining the Government’s ability to pursue unsustainable budget deficits through printing money.

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**The exchange rate historically has been seen as an important policy instrument for promoting economic growth and prosperity through international trade**

Because of its multifaceted roles, the choice of an exchange rate regime and its use as a policy tool have always generated debates.\(^{20}\) The exchange rate historically has been seen as an important policy instrument for promoting economic growth and prosperity through international trade. Thus, its stability is regarded as vital for achieving economic progress. Adjustments to the exchange rate are made in response to severe imbalances in the balance of payments in order to restore international competitiveness. Earlier debate on the exchange rate revolved around the effectiveness of devaluation in improving the balance of payments.\(^{21}\) In recent times, however, the exchange rate has been used as a tool for macroeconomic stabilization. For example, firmly pegging the domestic currency to the currency of a country with low inflation, known as a *nominal anchor*, is suggested for bringing hyperinflation under control. Adjustment of the exchange rate (mainly devaluation) is a common element of the rescue package of the IMF.\(^{22}\)

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**Exchange rate policies have important bearings for poverty reduction**

Although historically one or the other role received more attention, both the microeconomic and macroeconomic roles are interdependent. For example, if the exchange rate policy is used to lower inflation (a macroeconomic function), it will also improve international competitiveness and induce structural change in favour of the tradable sector (a microeconomic function). To the extent that macroeconomic stability and international competitiveness contribute to economic growth, exchange rate policies have important bearings for poverty reduction. Furthermore, the overall macroeconomic policy stance (fiscal, monetary and exchange rates) must be consistent with the trade policy stance for maximizing the impact of poverty reduction efforts.

In the last three decades, most developing countries experienced major changes in their exchange rate regimes as they opened up their economies. For example, 87% of developing countries had some type of pegged exchange rate policy in 1975 but by 1996 this proportion had fallen to well below 50% (Caramazza and Aziz, 1998). Although these countries moved officially away from a fixed exchange rate regime, they were not fully flexible in practice. Their exchange rate regime may be characterized as “fixed-but-adjustable”. However, many observers have been quick to attribute the 1997-1998 Asian financial crisis and currency crises in other emerging
economies to their pegged exchange rates (in practice), or a “fixed-but-adjustable” regime.23

The choice of an exchange rate regime must be based on the specific characteristics of a country

The currency crises have prompted suggestions for a more flexible exchange rate regime, but a more flexible exchange rate is not always an optimum policy for the developing world. For example, Eichengreen (1999) found that, of 29 cases, 23 countries had abandoned fixed exchange rate regimes in favour of more flexible ones, and the change was accompanied by a financial crisis. Corden (2002) convincingly argued that exchange rate regimes are not the root cause of economic crises, but they can either mitigate or militate the crisis once it is set off. Thus, regardless of the exchange rate regimes, developing countries may experience financial crises. Most observers believe that the exchange rate is not a panacea for all problems, and the choice of a regime must be based on the specific characteristics of a country. The theoretical and empirical literature overwhelmingly supports an intermediate exchange rate regime for developing countries. For example, Bordo (2003), working under the auspices of the IMF, reviewed the historical experience of exchange rate regimes and concluded that those countries which are still not financially mature should adopt an intermediate arrangement. This conclusion is consistent with that of other studies, such as those by Corden (2002) and Edwards and Savastano (1999).24 It is also important to bear in mind Frankel’s (1999) observation that “no single currency regime is best for all countries, and that even for a given country it may be that no single currency regime is best all time.” Thus, simplistic recommendations for exchange rate regimes based on macroeconomic performance can be extremely hazardous.25

However, from the perspective of poverty reduction, a number of factors should be considered when choosing an exchange rate regime. They are:

(a) The need for ensuring economic growth, and the role exports and FDI play. The empirical evidence shows that exchange rate volatility adversely affects both exports and FDI;
(b) The need to stabilize an economy in the light of empirical evidence that a downturn affects poverty more adversely than a boom reduces poverty;
(c) Given the condition of the financial market, the possibility of banking and financial crises in the face of increased short-term capital flows.

These considerations indicate that a developing country should follow an exchange rate stability approach. This may mean some loss of monetary independence. This will not matter when the economy is doing well as exports grow and FDI flows in. Furthermore, a country following this approach does not necessarily lose monetary independence. It can retain monetary independence with some control on short-term capital mobility or if capital flows are not significant. An important lesson of the Asian financial crisis is that nominal stability must not end up in real appreciation.

When there is a negative shock or a boom ends, a country should have the ability to adjust its exchange rate downward, that is, it should adopt the real target approach. When the exchange rate is allowed to depreciate, a country also gains the ability to use fiscal-monetary policy to stabilize the economy and minimize the adverse effects on poverty. The cautionary note here is that Governments may delay depreciation for political reasons, which can throw the economy into deeper recession.
Capital flows: managing enhances policy space and mitigates financial sector fragility

The opening of the capital account is seen as essential for encouraging capital flows and the development of the domestic capital market. These are expected to enhance both the volume and efficiency of investment and hence, economic growth. However, empirical evidence of the growth-enhancing effect of capital account liberalization (CAL) is mixed. In surveying the empirical literature, Cobham (2001, p. 5) concluded: “… that the (net) benefits of CAL for developing countries have not been established. Indeed … it is more accurate to say that these benefits may not necessarily exist for poorer countries”.

There are a number of shortcomings of capital account opening

Critics have pointed out a number of shortcomings of a generalized prescription for capital account opening for all countries regardless of their level of development.27 First, the target of capital account convertibility is mainly short-term portfolio capital and not the long-term FDI that developing countries need the most. FDI is not known to depend greatly on capital account opening. On the other hand, capital account liberalization makes it easy for FDI to leave a country. In order to remain attractive, developing countries end up offering various tax concessions – often they race to the bottom. This means that the burden of raising (or maintaining) fiscal revenue shifts from capital income to labour income. As a result, the after-tax income distribution is likely to become more unequal, which reduces the growth elasticity of poverty reduction.

Second, the prospect of capital flight forces Governments to adopt a very conservative fiscal policy stance (Stiglitz, 2000). Given the limitation of raising revenues, in most cases, this means cuts in government expenditure, especially in the social and infrastructure sectors. Thus, the prospect of capital flight restricts a country’s ability to use fiscal and monetary policies to address such issues as investment in infrastructure, priority sector development and human development, which are more important to attract FDI than capital account convertibility.

Third, countries at the lower level of development do not have an adequate institutional and legal framework to handle capital flows nor are they attractive for such flows. Instead, they face the problem of capital flight. Thus, capital account opening in most cases is found to increase capital outflows, not inflows. In order to prevent capital outflows, these countries are forced to maintain high domestic interest rates, which adversely affect domestic investment, especially in SMEs. On the other hand, if the high domestic interest rate attracts capital inflows, it can adversely affect a country’s international competitiveness and the pace of industrialization due to a Dutch disease-like syndrome. This happens as a result of a real appreciation in the value of domestic currency. Under a flexible exchange rate system, demand for domestic currency by foreign investors is likely to lead to nominal and hence real appreciation. Under a fixed exchange rate regime, the accumulation of foreign currency by the central bank will cause monetary expansion and hence, inflation. Therefore, in either case, there will be real appreciation.

This was exactly what happened in South-East Asian countries prior to the crisis. If the Government tries to sterilize the effect of capital flows on money supply by issuing bonds, it will further push up the interest rate, causing crowding out of private investment and fuelling more capital inflows.

In the Asian crisis even countries at a higher level of development found it difficult to handle short-term capital flows

On the other hand, if the Government channels the inflows through commercial banks, the banks will have excess liquidity. This may tempt commercial banks into a more lax scrutiny of loan applications, which increases the fragility of the banking sector.
Therefore, capital inflows are not costless; large capital flows can make macroeconomic management more difficult and the financial sector fragile. As the Asian crisis has amply demonstrated, even countries at a higher level of development (often referred to as emerging market economies) found it difficult to handle the uncertainty and volatility of short-term capital flows.

The same experience is being repeated during the ongoing economic crisis in Europe and the United States. Private capital flows to emerging economies rebounded from their short-lived slump in the last quarter of 2008 and early 2009. Net private inflows to emerging economies are estimated to have been $825 billion in 2010, up from $581 billion in 2009. The prospects of relatively slow growth and low interest rates in advanced countries, rapid growth and higher interest rates in emerging markets and reduced risk aversion suggest that private capital flows may continue to surge. This is putting upward pressure on exchange rates, denting export competitiveness and threatening to stifle their economic recoveries. The surge is also forcing reserve accumulation, which, if left “unsterilized”, adds to inflationary pressures and could trigger asset bubbles. Additionally, persistent vulnerabilities in advanced countries could trigger a new shock (for example, much higher policy rates, or even a recession) and transform the feast of capital flows into a famine, with serious destabilizing effects for receiving countries.

In response, a number of countries, including Brazil, Indonesia, the Republic of Korea and Thailand, have introduced defensive measures against capital flows. India and the Republic of Korea may tighten their controls even further, while central banks in emerging market economies are very worried about “hot-money” flows. Similarly, during the 1990s, policymakers in Chile, China, Colombia, India, Malaysia, Singapore and Taiwan Province of China used capital account management techniques to achieve crucial macroeconomic objectives. These included: preventing maturity and locational mismatches; attracting desired foreign investment; reducing overall financial fragility, currency risk and speculative pressures; insulating against the contagion effects of financial crises; and enhancing economic and social policy space.

In support of their argument, critics of full capital account convertibility used the evidence of successful economies, such as Malaysia, the Republic of Korea and Taiwan Province of China, which had capital controls in place during the periods of their rapid transformation. In fact, it is now widely accepted that China, India and Viet Nam were able to avoid the contagion of the Asian financial crisis due to controls on their capital account (Islam and Chowdhury, 2000). Most observers believe that Malaysia’s belated action to restrict capital mobility was the right step that helped it ride over the financial crisis of 1997-1998.

From a developmental perspective, capital account openness should not be viewed as an all-or-nothing position

Capital flows management is a sovereign right of a country under the IMF Articles of Agreement (Article VI). Owing to increased risks arising from volatile capital flows, IMF has recently designed capital flows management techniques. It notes:

Rapid capital inflow surges or disruptive outflows can create policy challenges. Appropriate policy responses comprise a range of measures, and involve both countries that are recipients of capital flows and those from which flows originate. For countries that have to manage the macroeconomic and financial stability risks associated with inflow surges or disruptive outflows, a key role needs to be played by macroeconomic policies, including monetary, fiscal, and exchange rate management, as well as by sound financial supervision and regulation and strong institutions. In certain circumstances, capital flow management measures can be useful. They should not, however, substitute for warranted macroeconomic adjustment.
Although now the IMF recognizes the perspective of many emerging and developing countries, critics believe that its guidelines on capital account management go only half way; it still sees capital account liberalization as a long-term goal. The Fund recommends restrictions on inflows only as a sort of “last resort” – when all other measures, such as building up reserves, letting currencies appreciate and strengthening fiscal policy have been adopted. More caution is urged when using regulation on outflows, arguing that by and large they should not be used but can be considered in crisis or near crisis conditions.

However, from a developmental viewpoint, capital account openness should not be viewed as an all-or-nothing position. The increased importance of equity flows has increased the effective scope of a capital account policy of semi-openness. A capital account can be open to equity flows – both portfolio and FDI, even when money and bond flows are managed. The benefits of managing short-term capital flows can be summarized as follows:

- Reduce the instability and possibility of crises arising from volatile international capital flows
- Insulate domestic interest rates, credit conditions and/or the exchange rate from international credit conditions
- Make some room for expansionary monetary policy

**KEY AREAS OF INCLUSIVE AND SUSTAINABLE DEVELOPMENT**

This section provides a rationale for public investment in key areas of inclusive and sustainable development. They include: ensuring productive and decent employment; providing better access to social services, including health, education, protection for persons with disabilities and old-age income security; and ensuring affordable access to energy. Together, at their basic levels, they afford social protection in the broader sense of the term and ensure resilient and inclusive development. Indeed, whether the terms are aspirational or intergovernmentally negotiated and legally binding, it has long been argued in international instruments that the guarantee of a certain standard of living is an inalienable human right.

In addition to rights-based arguments, there are also economic and social benefits to ensuring that all individuals have income security as well as universal access to basic services, such as health and education. Indeed, “a robust system of social protection not only fulfils people’s basic rights, it also establishes a firm platform for both social and economic development and provides an automatic stabilizer for vulnerable groups affected by crisis” (ESCAP, 2011c, p. 3). There is evidence to suggest that, in the Asian and Pacific region, a direct correlation exists between robust social security mechanisms and human development (see figure 3.3).

In recognizing the central role of social protection, especially during a crisis, the United Nations System Chief Executives Board for Coordination launched the social protection floor initiative in April 2009. That initiative is defined by the Board as “an integrated set of social policies designed to guarantee income security and access to social services for all, paying particular attention to vulnerable groups, and protecting and empowering people across the life cycle” (ILO and WHO, 2011, p. 9).

The global leaders gathered at the High-level Plenary Meeting of the sixty-fifth session of the General Assembly in September 2010 (the Millennium Development Goals Summit) declared: “We consider that promoting universal access to social services and providing social protection floors can make an important contribution to consolidating and achieving further development gains. Social protection systems that address and reduce inequality and social exclusion are essential for protecting the gains towards the achievement of the Millennium Development Goals”.

In June 2012, a new international labour standard, Social Protection Floors Recommendation, 2012 (No. 202), was adopted at the International Labour
Conference. In this first autonomous social security recommendation to be voted on in 68 years, there is a call for the provision of essential health care and benefits as well as basic income security constituting universal national social protection floors (SPF), which are nationally defined sets of basic social security guarantees with secure protection aimed at preventing or alleviating poverty, vulnerability and social exclusion. Moreover, in underlining the importance of universal access to services, the Secretary-General launched in September 2012 a major new initiative, *Global Education First Initiative*, to galvanize Governments and all other sectors of society into action on education and to get all children into school, to make sure that they learn and that what they learn is relevant for addressing today’s global challenges.

The argument for the universality of social protection does not imply homogeneity of mechanisms. Flexibility at the national level based on needs and capacities is needed. Governments need to design their floors according to national economic constraints, political dynamics and social aspirations. Rather than being based on a specified list of benefits, the SPF concept is focused on outcomes in terms of internationally recognized standards.

Nowhere is this idea of developing a plurality of social protection floors and staircases more germane than in Asia and the Pacific. The striking diversity of the region implies that countries have different social protection mechanisms in place and have different human development needs, fiscal space and tradeoffs. Nevertheless, the notion of an SPF can be used as a benchmark to advance social protection in a diversity of national contexts and in a diversity of directions.

The normative force of the SPF initiative rests in the fact that in the developing countries of Asia and the Pacific social protection, where it exists, is often limited to income security. Universal access to education and health are the exception. Even income security tends to be limited to contributory schemes, meaning that the large numbers employed in the informal sector as well as children and older persons are excluded. This situation is of special concern when considering women, who are disproportionately employed in the informal sector, and persons with

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**Figure 3.3. Social protection spending versus human development in the Asia-Pacific region**

Source: ESCAP calculations based on various sources.

*Note:* The size of bubbles represents purchasing power parity-adjusted per capita GDP in constant 2005 international United States dollars.
disabilities, who have more limited access to jobs and appropriate education.

On average, the Asian and Pacific countries spent 3.6% of their GDP on social protection (excluding health expenditure) in 2004/05. According to the World Social Security Report 2010/2011 (ILO, 2010c), among the regions of the world total social security expenditure at 6.9% of GDP is the second lowest in Asia-Pacific countries; sub-Saharan Africa is at the bottom with 4.8% of GDP spent on social security. When weighted by population, the figure becomes 5.3% for both Asia and the Pacific and Sub-Saharan Africa as opposed to global average of 8.4%. Greater efforts must therefore be made to strengthen the social pillar of sustainable development, particularly as higher social protection expenditure is associated with lower poverty prevalence: in countries such as the Lao People’s Democratic Republic and Nepal, which spend less than 5% of GDP on social protection, more than three quarters of the population lives in poverty, whereas in Kazakhstan and Mongolia, which dedicate approximately 10% of their GDP to social spending, less than 30% of their populations live in poverty.

**Employment for all**

More than six decades ago the world leaders who gathered in San Francisco in 1945 to sign the Charter of the United Nations declared that “…the United Nations shall promote: ... higher standards of living, full employment, and conditions of economic and social progress and development” (Article 55). Full or high employment was also the objective of international financial institutions. For example, according to the IMF Articles of Agreement that were adopted at Bretton Woods in 1944, the purpose of this institution is “…to contribute ... to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy” (Article I.ii).

International standards on the right to work include Article 23 of the Universal Declaration of Human Rights that guarantees everyone “the right to work, to free employment, to just and favourable conditions of work and to protection against unemployment”. At the World Summit for Social Development, held in 1995 in Copenhagen, Heads of State or Government from 117 countries pledged to promote “the goal of full employment as a basic priority of [their] economic and social policies” (United Nations, 1995).34 Millennium Development Goal 1 includes Target 1b: “Achieve full and productive employment and decent work for all, including women and young people”, which was added as an additional target to strengthen the importance of employment to eradicate extreme poverty and hunger.

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**A large number of workers are engaged in informal and vulnerable employment**

Despite rapid economic growth, a large of number of workers in the Asia-Pacific region are engaged in informal and vulnerable employment. Additionally, in many countries in the region, the share of the labour force working in agriculture is larger than the agricultural sector’s share in GDP, implying low productivity and wages and displaying a situation described as “disguised” unemployment. For instance, in Nepal, India and Viet Nam more than half of the labour force is employed in agriculture, whereas the shares of agriculture in their GDP ranges from 14% (India) to 35% (Nepal). In Papua New Guinea about 90% of the labour force is occupied in rural areas, whereas agriculture constitutes about 36% of GDP. Moreover, the share of labourers that works outside of agriculture and that is in informal employment, comprising workers in small enterprises of fewer than five workers, self-employed own-account workers, unpaid family helpers and workers with no proper contract in the formal sector, ranges from 12% of the labour force in the Russian Federation to more than 80% in India and in Nepal (see table 3.3). For many countries, the main challenge facing labour markets is therefore the high degree of informality that persists despite strong economic growth (ILO, 2012e).
Youth unemployment represents a further significant challenge in the Asia-Pacific region, especially in South Asia which is experiencing a shift in population composition towards the working ages. Despite having the lowest rates among developing regions, youth unemployment reached 9.8% in South Asia and 9% in East Asia in 2011 (ILO, 2012d). In Hong Kong, China, the official youth unemployment rate reached 16.6% in August 2011, yet it could be twice as high if all of the additional inactive youth that are really holding out hope for future employment are also counted (ILO, 2011b). Overall, in East Asia and South Asia the young are three to five times, respectively, more likely than adults to be unemployed. Youth make up nearly 60% of the unemployed population in Samoa and 50% in Vanuatu. Moreover, in recent years youth unemployment has bucked the overall unemployment rate that is trending downward in some countries (ILO, 2012e). In part, weak education and training systems have been unable to supply the skills required by labour markets as rapid structural transformation and changing skills requirements are taking place. However, in many countries, available job openings are limited in the formal sectors, which is further limiting the absorption rate of young workers into the labour force.

Given the missed opportunity of putting available resources to work and fostering development, and in considering the negative impacts of unemployment and underemployment on social outcomes, concerted efforts by the State to foster job creation should represent a core element of national development policy in Asia and the Pacific. By providing labour opportunities through public works programmes, job guarantees or wage subsidies, for instance, Governments would provide an important safety net for vulnerable workers and workers in the informal sector.

### Job guarantee schemes for the educated unemployed youths linked to active labour market programmes

Job guarantee schemes for the educated unemployed youths linked to active labour market programmes would contribute to improving their skills, thereby improving employment prospects. This would also create a “reserve army” of skilled workers for the private sector to draw from.

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**Table 3.3. Informal employment and employment in agriculture in selected countries, latest available data**

<table>
<thead>
<tr>
<th>Country</th>
<th>Persons in informal employment (percentage of non-agricultural employment)</th>
<th>Employment in agriculture (percentage of total employment)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nepal</td>
<td>86.4</td>
<td>73.9(^a)</td>
</tr>
<tr>
<td>India</td>
<td>83.6</td>
<td>51.1</td>
</tr>
<tr>
<td>Pakistan</td>
<td>78.4</td>
<td>44.7</td>
</tr>
<tr>
<td>Indonesia</td>
<td>72.5</td>
<td>38.3</td>
</tr>
<tr>
<td>Philippines</td>
<td>70.1</td>
<td>35.2</td>
</tr>
<tr>
<td>Viet Nam</td>
<td>68.2</td>
<td>51.7</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>62.1</td>
<td>32.6</td>
</tr>
<tr>
<td>Thailand</td>
<td>42.3</td>
<td>41.5</td>
</tr>
<tr>
<td>Fiji</td>
<td>33.7</td>
<td>12.8</td>
</tr>
<tr>
<td>China</td>
<td>32.6</td>
<td>39.6</td>
</tr>
<tr>
<td>Turkey</td>
<td>30.6</td>
<td>23.7</td>
</tr>
<tr>
<td>Armenia</td>
<td>19.8</td>
<td>44.2</td>
</tr>
<tr>
<td>Russian Federation</td>
<td>12.1</td>
<td>9.7</td>
</tr>
</tbody>
</table>

**Sources:** ILO, Statistical update on employment in the informal economy (June 2012) (for informal employment); and World Bank, World Development Indicators Database (for employment in agriculture).

\(^a\) Figure from International Labour Organization, *Labour and Social Trends in Nepal 2010* (Geneva, 2010).
of skilled workers for the private sector to draw from. Moreover, wage subsidies, such as the short-work scheme in Germany (Kurzarbeit), could stimulate demand or provide incentives for re-employment. These subsidies could, for instance, either take the form of direct payments to employers, reductions in social security contributions for newly hired, vouchers for employees or income tax credits.

Overall, job guarantees and wage subsidies would provide a buffer at the time of economic slowdown and would strengthen automatic stabilizers. Such programmes could also have important spillover effects on national economies and should be viewed as productive investments. For instance, programmes focused on infrastructure development, tackling soil erosion and irrigation could enhance productive capacities. If designed carefully, such programmes could also contribute to greening of the economy. For instance, employment activities can be created that perform environmental services, transform buildings and public infrastructure for more efficient energy consumption, support “green” research efforts and contribute to greater environmental sustainability (Forstater, 2001).

**Income security for the elderly**

So far, Asia’s growth performance has been strongly supported by favourable population dynamics taking the form of a large young workforce. However, the demographic transformation that the region is facing poses both challenges and opportunities. In several countries, rapid changes in life expectancy and lower rates of fertility are fuelling a demographic transition towards an older population structure. This transition is progressing at a speed far greater than the transition that affected developed regions, with the share of the population exceeding 65 years of age expected to nearly triple between now and 2050 in non-OECD Asia and the Pacific, from 6% of the population to 17%. By 2050, an estimated 922 million people, more than 60% of the global population more than 65 years of age, will live in Asia, compared with just a little more than half in 2000.

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**Rapid rates of urbanization and other social changes are contributing to a breakdown of informal generational contracts**

Given a context of much greater longevity, Governments will need to ensure that their social protection schemes deliver both for current and future generations (ILO and WHO, 2011). Traditionally, societies in the region have relied on informal family-based support systems for old-age income security. Yet, rapid rates of urbanization and other social changes are contributing to a breakdown of these informal generational contracts. Indeed, an estimated 80% of the world’s population do not have sufficient protection in old age to enable them to face health, disability and income risks, and more than half lack any kind of social security coverage at all.

Almost all countries in the region have some sort of formal pension scheme. Yet, such schemes usually cover only the public sector. While a pension scheme may also extend to workers who are formally employed in the formal sector, overall coverage of the labour force is relatively low (see figure 3.4). Thus, in the developing economies of Asia an estimated eight out of 10 workers are still not covered by a pension scheme. Women have especially limited access to pensions, although they comprise a large proportion of the population 65 years and older, including the oldest of the old (exceeding age 80). In developed regions, coverage of about 90% of the labour force is the norm. Moreover, in Asia the coverage of pension systems is in general skewed towards urban areas and the formal sector. In China, for instance, less than 10% of rural workers have pension coverage.

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**The vulnerability of older persons calls for the introduction of a mechanism that provides some form of income-security**

The lack of formal pension systems that cover large proportions of older persons in most countries implies
that many, especially those who are single, widowed or childless (particularly women), face a high risk of destitution in old age. The vulnerability of older persons, especially in the informal sector, calls for the introduction of a mechanism that provides some form of income-security for these persons.

Financed out of general taxation, a non-contributory pension is not necessarily regressive (Devereux, 2001). Indeed, several countries in the region have introduced such a pillar. In Thailand, for instance, a means-tested social pension (cash transfer scheme) exists for vulnerable older people (60 years and older); this scheme covers approximately 25% of the target population and pays benefits equivalent to one-thirds of the national poverty line. Similarly, in India the National Old Age Pension Scheme covers about half the people 65 years and older who are under the poverty line and destitute with little or no regular means of subsistence. Several countries in the region have gone further by introducing universal non-contributory programmes; others plan on doing so. In existing programmes, eligibility is based on having reached a certain age and benefits are not means-tested. In Nepal, for instance, a universal non-contributory pension scheme was introduced in 1995, which granted everyone older than 75 years of age a pension benefit. In 2009, the eligible age was reduced to 70 years (and to 60 years in one part of the country). A universal, non-contributory pension scheme has also been operational in Brunei Darussalam since 1984, covering residents aged 60 and older, while in Viet Nam a universal pension scheme was introduced in 2004 for people older than 90 years (in 2007, eligibility was reduced to 85 years). In the developing Pacific countries, universal retirement pensions are paid in Samoa from age 65 and in Kiribati from age 70. Meanwhile, in India momentum towards the introduction of a universal scheme is building.

Income security for persons with disabilities

WHO estimates that 15% of the world’s population, that is, about 1 billion persons, live with some form of disability (WHO, 2011); out of this, approximately 650 million persons with disabilities live in the Asia-Pacific region. Social protection coverage in the developing countries in Asia and the Pacific is often limited to social insurance programmes which are available only to those with regular employment contracts in the formal sector, leaving the vast majority of the population, especially persons with disabilities, without sufficient coverage (ESCAP, 2012e). According to a recent study (ESCAP, 2012a), more than 70% of persons with disabilities did not have enough income for self-support, and many of them were
not given equal opportunities for employment in decent work due to discriminatory attitudes, the lack of supportive legal and policy systems and inaccessible transportation and buildings.

Political and economic pressure for social protection for persons with disabilities will most certainly increase in the coming decades as the number of persons with disabilities is expected to increase dramatically as a result of population ageing. Higher disability prevalence at older ages combined with rapidly ageing populations will therefore result in a stronger focus being put on persons with disabilities in almost all countries. In China, for instance, 53% of persons with disabilities were aged 60 and older in 2006 and the share of this age group is projected to rise at an accelerated pace in the future, to reach 70% in 2025 and 83% in 2050 (see table 3.4).

Research in developing countries indicates that disability is significantly associated with multidimensional forms of poverty, which persons with disabilities experience at higher rates and severity than persons without disabilities (Mitra, Posarac and Vick, 2012). Disability also contributes to poverty by hampering the full participation of persons with disabilities in the economic and social life of their communities, essentially limiting the range of support structures upon which they may fall back.

Building viable supportive environments for persons with disabilities and their families is gaining political momentum as the United Nations is taking concerted action towards a disability-inclusive development framework beyond 2015. With efforts under way to redefine the global development landscape over the course of the next several years, Asia-Pacific countries have extraordinary opportunities to achieve a truly transformative development agenda that would include a “disability lens” that would be both equitable and socially inclusive of persons with disabilities.

The High-level Intergovernmental Meeting on the Final Review of the Implementation of the Asian and Pacific Decade of Disabled Persons, 2003-2012, which was convened by ESCAP and held in Incheon, Republic of Korea, from 29 October to 2 November 2012, was a prelude to such initiatives. That meeting charted the course for the new Asian and Pacific Decade of Persons with Disabilities, 2013-2022, by adopting the world’s first set of regionally agreed disability-inclusive development goals, namely the Incheon Strategy to “Make the Right Real” for Persons with Disabilities in Asia and the Pacific (ESCAP, 2012d).

### Health for all

The linkages between health and poverty reduction and long-term economic growth are powerful and much stronger than generally understood (WHO, 2001). For one, a healthier population is able to be productive as workers take less time to recover and spend less time looking after ill dependents. At the same time, healthier individuals spend less on health-related goods and services and can save more, which will make more capital available for development.

### Table 3.4. Proportion of older persons (aged 60+) in the group of persons with disabilities

<table>
<thead>
<tr>
<th>Countries</th>
<th>Most recent data</th>
<th>2025</th>
<th>2050</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>48.9</td>
<td>55.9</td>
<td>62.4</td>
</tr>
<tr>
<td>China</td>
<td>53.2</td>
<td>70.2</td>
<td>82.7</td>
</tr>
<tr>
<td>India</td>
<td>17.6</td>
<td>27.0</td>
<td>41.1</td>
</tr>
<tr>
<td>Lao People's Democratic Republic</td>
<td>18.1</td>
<td>25.3</td>
<td>46.3</td>
</tr>
<tr>
<td>Republic of Korea</td>
<td>50.4</td>
<td>67.1</td>
<td>77.6</td>
</tr>
</tbody>
</table>

Source: ESCAP, Disability at a Glance 2012: Strengthening the Evidence Base in Asia and the Pacific (Bangkok, 2012).

a Australia (2009); China (2006); India (2001); Lao People’s Democratic Republic (2005); and Republic of Korea (2010)
b ESCAP projection.
Tremendous improvements in health outcomes have been registered in the region: in a number of countries, the under-five mortality rates declined by more than 40% between 2000 and 2010, including in Bangladesh, Cambodia, China, Malaysia, Maldives, Mongolia, Nepal and Vanuatu. Maternal mortality rates have been more than halved in Cambodia, Mongolia and Viet Nam. Indeed, overall improvements in health outcomes have led to an overall increase in life expectancy in the region, with gains of more than five years being registered in the decade to 2010, in Bhutan, Cambodia, the Lao People’s Democratic Republic, Mongolia and Timor-Leste. In Maldives and Nepal, life expectancy has increased by more than six years.

Public health coverage could be improved in many countries

Despite these improvements, public health coverage could be improved in many countries including more attention to non-communicable diseases. While public health expenditure averages approximately 60% of total health expenditure in the developing countries in the region, such expenditure is particularly low in the least developed countries in Asia and the Pacific. In Afghanistan and Myanmar, public expenditure accounts for only about 12% of total health expenditure; in Bangladesh, the Lao People’s Democratic Republic, and Nepal, it only accounts for about a third of total expenditure. Public expenditure is also very low in India, amounting to less than 30% of all health expenditure. At the same time, there is a wide variety in the degree of access to and availability of health services: in Cambodia there are 10 times as many physicians as in Bhutan per population size (23 per 100,000 inhabitants versus 2.3), while Malaysia has four times as many physicians per population size, as Cambodia. In terms of the availability of hospital beds, estimates range from a low of 30 beds per 100,000 in Bangladesh to 590 in Timor-Leste.

While there is clear evidence that the lower is an individual’s socioeconomic position, the worse is his or her health, and inequities in health within countries in the region can be significant. For instance, in India, only 36% of children in the poorest quintile receive all three doses of the DPT (diphtheria, pertussis and tetanus) vaccine to obtain immunity against three of the six major preventable childhood diseases. Of the richest quintile, 85% of the children receive all three doses. This may contribute to the result that children born in the poorest quintile of households in India have a 40% higher risk of dying before reaching the age of five than children born in the richest quintile. In a similar vein, the decline in the average under-five mortality rate observed in Bangladesh between 1997 and 2004 for the poorest 20% of the population was less than half of the decline observed for the population as a whole (WHO, 2009b). Part of this phenomenon may be due to large inequities in the availability of skilled attendants during delivery, which covers only 13% of women in both Bangladesh and Nepal, compared with rates exceeding 95% in Sri Lanka and Thailand.

An important element in reducing health inequities within countries is therefore the achievement of universal health coverage. This term is defined as ensuring that all people have access to needed promotive, preventive, curative and rehabilitative health services of sufficient quality to be effective, while also ensuring that people do not suffer financial hardship when paying for these services (WHO, 2013). Universal health coverage is an important component to foster inclusive and socially sustainable development, and typically embodies three objectives, namely equity (that health services cannot be restricted to those who can afford them); quality (that services are capable of improving the health of those seeking the services) and affordability (that the cost of acquiring these services does not entail placing oneself into financial hardship).

In 2011, 193 Member States of WHO made a commitment to move towards universal health coverage. Yet, progress has been patchy. Indeed, owing to a lack of universal health coverage, more than 100 million people are pushed into poverty annually and 150 million people face financial hardship
because they have to pay directly for the health services they use at the point of delivery (WHO, 2010b). With an obvious link between catastrophic out-of-pocket expenditures on health care (defined as out-of-pocket health payment exceeding 40% of a household’s non-subsistence spending) and the risk of falling into poverty (see figures 3.5 and 3.6), greater effort needs to be made to strengthen health coverage and to make it universal.

This is especially the case in the Asia-Pacific region, where only 20% of the regional population has access to health-care assistance and where out-of-pocket medical expenses are among the highest in the world. In South Asian countries only 8% of the population is covered by health-care programmes (ESCAP, 2010a). To this extent, the General Assembly in December 2012 once again urged “Governments, civil society organizations and

Figure 3.5. Households impoverished as a result of catastrophic out-of-pocket expenditures


Figure 3.6. Catastrophic and total health expenditure

international organizations to promote the inclusion of universal health coverage as an important element in the international development agenda.\textsuperscript{36}

**Education for all**

Education has also long been found to be one of the cornerstones of inclusive and sustainable development. More education contributes positively to labour productivity and is generally associated with higher wages. Moreover, the return on investment and expenditure in education is high, particularly for less developed countries (see table 3.5). In Asia, it is on average higher than 10% for all three tiers of education. At the same time, more education, particularly of females, has important health impacts on children and contributes to lower levels of fertility, irrespective of level of development. Thus, there is a clear positive effect between education and health outcomes, earnings and higher economic growth.

At the World Conference on Education for All, held in Jomtien, Thailand, in March 1990, the global community pledged to achieve universal primary education by 2000. As that deadline had already passed more than a decade ago, achieving universal enrolment in primary education became one of the core Millennium Development Goals agreed in 2000. Moreover, in 2000, 164 Governments reaffirmed their commitment to achieving "education for all" by the year 2015 at the World Education Forum, which was held in Dakar in April 2000.

Many countries in the region have already achieved universal primary education; several others are on track to do so. Nevertheless, of the estimated 61 million children of primary school age who were out of school in the world in 2010, one fifth (13 million) were in South Asia. In relative terms, 7% of children of primary school age in South Asia were not in school (UNDESA, 2012a). Moreover, in South Asia, girls accounted for 55 per cent of the total share of out-of-school children.

<table>
<thead>
<tr>
<th>Region</th>
<th>Social movement</th>
<th>Private movement</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Primary</td>
<td>Secondary</td>
</tr>
<tr>
<td>Asia\textsuperscript{a}</td>
<td>16.2</td>
<td>11.1</td>
</tr>
<tr>
<td>China</td>
<td>14.4</td>
<td>12.9</td>
</tr>
<tr>
<td>India</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>Nepal</td>
<td>15.7</td>
<td>8.1</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>12.8</td>
<td>19.4</td>
</tr>
<tr>
<td>Philippines</td>
<td>13.3</td>
<td>8.9</td>
</tr>
<tr>
<td>Singapore</td>
<td>16.7</td>
<td>10.1</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>Thailand</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>Viet Nam</td>
<td>13.5</td>
<td>4.5</td>
</tr>
<tr>
<td>Europe/Middle East/North Africa\textsuperscript{a}</td>
<td>15.6</td>
<td>9.7</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>17.4</td>
<td>12.9</td>
</tr>
<tr>
<td>OECD</td>
<td>8.5</td>
<td>9.4</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>25.4</td>
<td>18.4</td>
</tr>
<tr>
<td>World</td>
<td>18.9</td>
<td>13.1</td>
</tr>
</tbody>
</table>

Source: Psacharopoulos and Patrinos (2004).\textsuperscript{37}

**Table 3.5. Returns to investment in education by level**

Note: Private returns are higher than "social" returns, defined on the basis of private benefits but total (private plus external) costs, due to the public subsidization of education and the fact that typical social rate of return estimates are not able to include social benefits.

\textsuperscript{a} Non-OECD.
The need for greater efforts to expand primary schooling in the region is thus apparent and Governments clearly need to devote more resources to increase primary school enrolment. Completing primary education is, however, not sufficient to prepare young persons for work in labour markets and provide them with the tools that these requires. As countries develop, demands for an increasingly sophisticated labour force rise to the extent that a secondary education will be essential in searching for the key to a better life, especially as developing countries ultimately will engage more in research and development at the tertiary level. However, with secondary enrolment rates reaching less than 50% in several countries in the region (see figure 3.7), Governments need to commit to achieve universal enrolment in secondary education and to intensify efforts to meet such a goal.

In addition to the quantitative objective of achieving universal primary education, efforts need to be made to improve educational quality. Reasons for this growing concern with the quality of education include: the inability to adequately finance and staff rapidly growing education systems; evidence of low levels of competence in basic skills; new demands for mathematics and computer skills stemming from the information technology revolution; and multiple economic and financial crises that have adversely affected budgets for education (Chapman and Adams, 2002).

**Energy access for all**

In December 2010, the General Assembly declared 2012 as the International Year of Sustainable Energy for All, recognizing that “… access to modern affordable energy services in developing countries is essential for the achievement of the internationally agreed development goals, including the Millennium Development Goals, and sustainable development, which would help to reduce poverty and to improve the conditions and standard of living for the majority of the world’s population”.

In June 2012, the United Nations Conference on Sustainable Development (Rio+20) reconfirmed the Secretary-General’s Sustainable Energy for All initiative, which includes three interlinked objectives to be achieved by 2030: (a) to ensure universal access to modern energy services; (b) to double the global rate of improvement in energy efficiency; and (c) to double the share of renewable energy in the global energy mix. The General Assembly subsequently declared 2014-2024 as the Decade of Sustainable Energy for All, underscoring the importance of energy issues for sustainable development and for the elaboration of the development agenda beyond 2015.

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**Figure 3.7. Gross and net enrolment rates in secondary education, latest available data**

![Bar chart showing gross and net enrolment rates in secondary education for various countries](chart.png)

*Source: ESCAP, based on World Bank World Development Indicators.*
In the Asia-Pacific region, two main energy challenges are related to providing universal access to sustainable energy supplies: (a) to meet existing shortfalls; and (b) to meet projected growth in energy demand, especially from major emerging economies in the region. Fortunately, the region has both conventional (e.g. coal, oil, gas) and renewable (e.g. hydro, solar, wind, geothermal) energy resources, which can be tapped to achieve the Sustainable Energy for All initiative. However, there are significant disparities in the Asia-Pacific region in terms of access to energy services, especially in terms of access to electricity, and access to modern cooking fuels (see figure 3.8). In the region, 1.7 billion people rely on traditional biomass and more than 600 million people live without electricity. In addition, more than 70% of the people in the Pacific subregion still do not have access to electricity.43 A total of 10 countries – four in developing Asia and six in sub-Saharan Africa – account for two thirds of those people globally without electricity; just 3 countries – Bangladesh, China and India – account for more than half of those without clean cooking facilities (IEA, 2012). However, the situation varies at the subregional level.

Of the more than 600 million people without electricity in Asia and the Pacific, the South and South-West Asian subregion alone accounts for about 449 million; these people are living in Bangladesh, India and Pakistan (IEA, 2011). In the South-East Asian subregion, there are about 81 million people in Indonesia and about 44 million in Myanmar who continue to live without access to electricity (IEA, 2011). In the Pacific subregion, only 10% of the households in Papua New Guinea have access to electricity (UNDP, 2009a). In the East and North-East Asian subregion, three countries, namely China, the Democratic People’s Republic of Korea and Mongolia, experience relatively low levels of electrification: 17.7 million people in the Democratic People’s Republic of Korea, 8 million people in China and about a million people in Mongolia live without access to electricity (IEA, 2011).

On the other hand, although access to energy services is not the primary energy-related challenge in North and Central Asia, there are concerns in some countries. For instance, 98% of the population of Kyrgyzstan has access to the electrical grid, but there are forced blackouts and rationing when...
Hydropower gets low during the winter (Abdyrasulova and Kravsov, 2009). Likewise in winters, more than 1 million people in Tajikistan, the total population of which is less than 7 million people, have little or no access to an adequate energy supplies (UNDP and UNEP, 2011).

Universal access to energy services is essential for increasing economic activities, which create opportunities for employment, not only for the poor. Similarly, the lack of access to modern cooking fuels poses a severe health hazard due to indoor air pollution caused by the burning of inefficient cooking fuels, such as traditional biomass. WHO (2006a) estimated that cooking with traditional fuels is a major risk factor for pneumonia among children and chronic respiratory disease among women in particular; the use of such fuels is responsible for 1.5 million deaths every year. Clearly, increasing access to modern, clean and efficient sources of energy is a key driver of inclusive and sustainable development.

The relationship between two key indicators of the universal access to modern energy services, namely the proportion of population without access to electricity and the proportion of population relying on traditional biomass for cooking, are closely related to development and poverty outcomes. Figure 3.9 illustrates a significant correlation between access to modern energy services and human development and poverty.

There is a significant correlation between access to modern energy services and human development.

Energy access indicators are positively correlated with human development (as measured by the Human Development Index). The scatter diagrams in the figure indicate that countries with better access to energy services tend to exhibit a higher level of human development. Better access to modern energy services provides households with opportunities to engage in productive activities and subsequently creates conditions for better jobs higher-level incomes. Evidence from the Asia-Pacific region indicates that access to energy services contributes to greater human welfare and increasingly higher levels of sustainable development.

Figure 3.9. Development and universal access to energy services, latest available data


Notes: The fitted line is based on an ordinary least squares regression. The size of bubbles represents purchasing power parity-adjusted per capita GDP at constant 2005 international dollars.
Critically, as population growth remains unabated in the Asia-Pacific region and urbanization continues, the demand for energy services will increase significantly to keep pace with the economic growth momentum. As shown in figure 3.10, the demand for energy in the region increased significantly over the last decade, from 39% of the world’s total in 2000 to 45% in 2008 (ESCAP, 2012c).

Since securing a stable source of energy services and making it available to households is an essential component for inclusive and sustainable development, Governments need to lay out investment strategies in energy infrastructure by detailing policy measures to improve access to modern energy services so as to enhance their impact on production activities for boosting economic outputs and social and health impacts. To overcome the growing challenges from the accessibility of the modern energy services and depletion of natural resources, Governments should address these policy matters on a timely basis and in a targeted manner to promote energy policies that are aimed at improving the efficiency and increasing the use of renewable energy in the country’s energy mix.

CONCLUDING REMARKS

The above discussion highlights the importance of forward-looking macroeconomic policies for achieving resilient and inclusive sustainable development. The lessons of the past indicate that macroeconomic policies need to be balanced between stabilization and development. This would entail the State assuming a greater role in investing in key areas of human development and social and environmental protection that would enhance the quality of growth in terms of resilience and inclusiveness, and hence strengthen the sustainability of development.

With public investment in employment guarantee schemes, health, education and social security, as well as through leveraging procurement expenditures, fiscal policy can be a crucial macroeconomic policy tool for attaining inclusive, equitable and sustainable development. The question is, however, are these investments too large to threaten fiscal or macroeconomic sustainability? In the next chapter, attempts are made to provide some tentative answers to this question.
Endnotes

1 See General Assembly resolution 66/288 of 11 September 2012.

2 See General Assembly resolution 48/96 of 20 December 1993.

3 See Report of the Secretary-General A/64/665: Keeping the promise - a forward-looking review to promote an agreed action agenda to achieve the Millennium Development Goals by 2015.

4 See Blanchard (2009)


6 See Blanchard (2009)

7 For further details, see IMF (2011).

8 United States dollars deposited in western banks by oil-exporting countries which enjoyed revenue windfalls as a result of the oil price hikes.

9 The following observation is made in the World Bank publication, entitled Economic Growth in the 1990s Learning from a Decade of Reform: “Another mistake often made in the 1990s has been the translation of general policy principles into a unique set of actions. The principles of ... ‘macroeconomic stability’ ... have been interpreted narrowly to mean ‘minimize fiscal deficits, minimize inflation, ... maximize liberalization of finance,’ with the assumption that the more of these changes the better, at all times and in all places — overlooking the fact that these expedients are just some of the ways in which these principles can be implemented” (p. 11, emphasis as in the original text).

10 For further details, see World Bank (2006). Additionally, the presumption that full employment and economic growth would follow as a result of price stability was contradicted by experience in both industrialized and developing countries. It would be pertinent to quote from a World Bank study:

Macroeconomic policies improved in a majority of developing countries in the 1990s, but the expected growth benefits failed to materialize, at least to the extent that many observers had forecast. In addition, a series of financial crises severely depressed growth and worsened poverty ...[B]oth slow growth and multiple crises were symptoms of deficiencies in the design and execution of the pro-growth reform strategies that were adopted in the 1990s with macroeconomic stability as their centerpiece (World Bank, 2005, p. 95).

11 For further details, see IMF (2004).

12 For a fuller treatment of this issue, see Akroyd and Smith (2007).

13 The study covered 10 economies: China; Indonesia; Japan; Malaysia; Philippines; Republic of Korea; Singapore; Thailand; Hong Kong, China; and Taiwan Province of China.

14 There is a caveat here. The argument assumes that real wages decrease with moderate inflation and wages are indexed to inflation.

15 Also see Islam and Anwar (2011).

16 The net revenue a government receives from printing money: the difference between the face value of coins and notes and the cost of producing and distributing them. When a government prints money, it is in essence borrowing interest-free since it receives goods in exchange for the money, and must accept the money in return only at some future time. It gains further if issuing new money reduces (through inflation) the value of old money by reducing the liability that the old money represents. These gains to a money-issuing government are called “seignorage” revenues.

17 See Pillarisetti (2007)

18 See Monterrey Consensus of the International Conference on Financing for Development (United Nations, 2002), Also, for global evidence and a general discussion on financial inclusion, see Allen and others (2012).

19 The ratio of two prices between tradable and non-tradable products or between domestic and foreign goods.

20 The choice of monetary and exchange rate regime became a subject of vigorous debate in the United Kingdom in the late nineteenth century following the fall in the price of silver, which caused a sudden and deep depreciation of the Indian Rupee relative to the British Pound. This event culminated in the establishment of the Royal Commission on Gold and Silver in 1886 to investigate the causes and effects of the drop in the price of silver. The debate has its modern parallel in the many crises of the “fixed-but-adjustable” exchange rate regimes. Chapter 2 in Corden (2002) contains
an excellent summary of the historical debates. A good historical perspective is also contained in Bordo (2003).

21 This debate produced the famous Marshall-Lerner conditions and highlighted the possibility of counter-productive competitive devaluation, popularly known as "beggar-thy-neighbour".

22 Typically the IMF package involves devaluation and fiscal-monetary consolidation.

23 According to Fischer (2001), each of the major international capital market-related crises since 1994 had in some way involved a pegged exchange rate regime.

24 Earlier studies, such as those by Crockett and Nsouli (1977) and Artus and Young (1979), also arrived at a similar conclusion. Artus and Young's research was conducted at IMF. See also Allegret (2007).

25 Sifting the country-specific studies, Edwards and Savastano (1999, pp. 11-12) concluded: “Not surprisingly, this country-specific literature found it very difficult to pin down the independent effects of the nominal exchange rate regime on the overall macro economic performance of developing countries. Every time the profession seemed to be reaching agreement on a feature or regularity distinctive of a particular regime based on analyses of the experience of a group of countries, developments in another group of countries provided a devastating counter-example that needed to be reckoned with” (emphasis original). Available from www.anderson.ucla.edu/faculty/sebastian.edwards/emerging.pdf

26 Available from www.aseminfoboard.org/content/documents/finnm3_chair.pdf.

27 See Montes (1998) for a discussion in the context of the Asian financial crisis. Fischer and Reisen (1993) is one of the earlier works that argued for caution.


29 See Gallagher and Ocampo (2013).

30 The 1948 Universal Declaration of Human Rights (General Assembly resolution 217 A (III)) provides the normative basis for the right to social security (art. 22). In the 1966 International Covenant on Economic, Social and Cultural Rights (General Assembly resolution 2200 A (XXI), annex), the "right of everyone to social security, including social insurance" (art. 9), is recognized. Furthermore, the 1979 Convention on the Elimination of All Forms of Discrimination against Women (United Nations, Treaty Series, vol. 1249, No. 20378) requires States parties to take appropriate measures to eliminate discrimination against women in the field of social security. More recently (2006), in the Convention on the Rights of Persons with Disabilities (United Nations, Treaty Series, vol. 2515, No. 44910), the right of persons with disabilities to social protection (art. 28) is recognized. In the regional context, one of the goals of the Incheon Strategy to “Make the Right Real” for Persons with Disabilities in Asia and the Pacific that provides a blueprint for implementation of the third Asian and Pacific Decade of Persons with Disabilities, 2013-2022, is strengthening social protection.

31 See General Assembly resolution 65/1, para. 51.

32 For the full text, see www.ilo.org/dyn/ normlex/en/?p=1000:12100:0::NO::P12100_INSTRUMENT_ID:3065524.

33 It is more accurate, then, to speak of social protection floors, in the plural, in the sense that SPF initiatives need to be operationalized in the light of country-specific circumstances.

34 See Commitment 3 in A/CONF.166/9.

35 “In some countries in the region, more than 60 per cent of money spent on health care comes from the patient’s pocket. By contrast, in Germany an average of just 13 per cent of all medical expenses are borne by the patient, with the rest covered by social health insurance or by the Government” (WHO, 2010a).

36 See A/67/L.36, para. 15.

37 Private returns exceed “social” returns in the table as the latter term is defined on the basis of private benefits but total (private plus external) costs and excluded social benefits, which are difficult to estimate.

38 See General Assembly resolution 65/151.

39 See also www.sustainableenergyforall.org/about-us.

40 Modern energy services include (a) electricity; (b) modern fuels (electricity, liquid fuels including liquefied petroleum gas (LPG), natural gas, kerosene, ethanol and biofuels, but exclude traditional biomass, such as firewood, charcoal, dung, crop residues and coal) to meet cooking needs; and (c) mechanical power for productive, non-industrial applications, such as water pumping and small-scale agroprocessing (UNDP, 2009a).


42 See General Assembly resolution 67/215.
Excluding Papua New Guinea, many countries have access rates of more than 90% and most of them exceed 50%. Yet, the Pacific subregion is the most fossil fuel-dependent region in the world. See www.spc.int/edd/en/section-01/energy-overview/160-2012-international-year-of-sustainable-energy.

Similarly, indicators of energy access services are negatively correlated with poverty outcomes (as measured by the proportion of people living on less than $1.25 a day). In addition, a higher level of energy access contributes to poverty reduction; it is especially highly correlated with access to electricity in the Asia-Pacific region.
We have to summon the imagination to balance the costs that we will incur in the present with the benefits that will accrue to future generations.

Manmohan Singh,
Prime Minister of the Republic of India

Fostering inclusive and sustainable development will require greater and sustained development-oriented investment. This chapter provides illustrative estimates of the investment and expenditure requirements of 10 countries in the Asia-Pacific region to sustain development-oriented public investments in six key areas: (i) employment for all; (ii) income security for the elderly; (iii) income security for persons with disabilities; (iv) health for all; (v) education for all; and (vi) energy access for all. The analysis finds that most countries can finance such a package without jeopardizing macroeconomic stability, although least developed countries would find it challenging to raise the required resources domestically.
In the previous chapter on forward-looking macro-econometric policies, it is argued that to engineer resilient, inclusive and sustainable development, countries would need to increase and sustain development-oriented public investments in six key areas: (i) employment for all; (ii) income security for the elderly; (iii) income security for persons with disabilities; (iv) health for all; (v) education for all; and (vi) energy access for all. In that chapter, it is also noted that these key areas for public policy actions were based on the current economic, social and environmental situation and needs in the Asia-Pacific region. As an illustration of possible cross-cutting policies, estimates are given in this chapter, on the public investment needs for delivering upon these six key policy areas in 10 countries: Bangladesh; China; Fiji; India; Indonesia; Malaysia; Philippines; Russian Federation; Thailand; and Turkey. The selection of these countries was based on the following criteria: (i) availability of time series data, including multiple indicators that are used to compute the required investment for each of the six programmes, (ii) geographic coverage, including all subregions of ESCAP; and (iii) level of development. Together, these countries account for more than 90% of the population of the developing countries in the Asia-Pacific region.

Providing employment for all

One approach to providing employment for all is for a government to act as an employer of last resort. Only then can the concept of a socially acceptable minimum wage to prevent poverty or working poor have any meaning. As an illustration, in this section, the required expenditure to provide a job guarantee programme is examined (see the appendix for a more detailed description of the methodology). This essentially hinges upon three factors: (i) eligibility and participation in the programme; (ii) duration for which the programme provides employment to participants, or provides subsidies; and (iii) the level of wages/subsidies that is paid per participant. To serve as an illustration, a job guarantee programme that is available to all participants in the informal sector is considered.

In terms of eligibility, any form of job guarantee should be universally available. In practice, however, such programmes often target the most vulnerable workers. This principally comprises workers in the agriculture sector who depend on either subsistence farming or on seasonal work (such as crop pickers), as well as all workers either informally working in the formal sector, or working in the informal sector. Regarding duration, job guarantee programmes should provide employment to participants for a clearly defined length of time so that it is known from the outset what income participants can rely on and what would be the maximum public investment per participant. In India, for example, the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) stipulates that 100 days of employment be made available to eligible participants. Finally, setting the level of wages is an important factor in the design of any job guarantee programme: if the wages are set too high, the programme would be competing with the private sector for workers while on the other hand, if the wages are too low, the attractiveness of the programme would be limited and could ultimately defeat its purpose of supplying sufficient means to earn a decent living. As a benchmark, job guarantee programmes should offer wages that are equal to the level of minimum wages. Use of minimum wages may, however, be impractical when devising a national programme as there may be many different minimum wages in a given country. In India, for instance, there are more than 1,000 different minimum wage rates that span sectors, states and occupations, although the current recommendation for a national minimum wage floor level is Rs.100/- per day (see India, Ministry of Labour, 2010). Similarly, there are more than 31 province-level minimum wage rates in China (ILO, 2012g). As an alternative baseline, wages that would bring workers to the national poverty line for the duration of the job guarantee programme could be considered. While national poverty lines within countries may differ across, for example, rural or urban sectors, as well as across states, there is typically less variation than across minimum wage levels, making it relatively easy to derive a national poverty line.
National poverty lines are selected as a benchmark for wages and social transfers

While the use of minimum wages is impractical (see above), using a benchmark such as the $1.25/day line for extreme poverty, or of $2/day for absolute poverty (both in 2005 constant PPP terms) may bear little relevance for those countries in the region that have high levels of income per capita. Thus, national poverty lines, which furnish a country specific estimate of what is deemed to be a required minimum to survive or to avoid becoming a working poor, are selected as a benchmark for wages and social transfers. Data collected on the 10 countries show a relatively wide dispersion of the national poverty line relative to per capita income among them, ranging from 6.5% of GDP per capita in China to more than 40% in Bangladesh (see figure 4.1).

A common definition of informal workers includes those working in agriculture as well as those in informal employment in non-agriculture. This measure reveals a large degree of variation in estimates, ranging from 20% of the labour force in the Russian Federation to more than 80% in Bangladesh and more than 90% in India (see figure 4.2). In part, this variation is due to large differences in the share of labour that works in agriculture, ranging from 9.3% in the Russian Federation to almost 50% in India. Also of note is the high degree of informality in non-agricultural employment in the region. In both India and Bangladesh, more than 40% of the labour force is comprised of workers in the agriculture sector. In Indonesia, agriculture only accounts for a quarter of the labour force. The overall high level of informal employment of the labour force – reaching 80% – is, however, driven by a high degree of informal employment in the non-agriculture sector.

The overall expenditure to provide a job guarantee for 100 days is fairly low in 10 countries that have been analysed in the region, ranging from slightly less than 1% of GDP in the Russian Federation and China to slightly more than 8% of GDP in Bangladesh in 2030 (see figure 4.3). These expenditures, which include administration costs equivalent to 50% of labour costs, vary due to differences in the size of the informal sector across countries and their national poverty lines.

Figure 4.1. Poverty line relative to GDP per capita and income per capita, latest available data

In some countries, high population growth rates will lead to an increase in the expenditure of a job guarantee programme, including, for instance, in Bangladesh. In most of them, however, the expenditure will remain relatively constant as a gradual decline in the agriculture sector, resulting in a decline of the proportion of workers in agriculture, offsets growth in the labour force. Moreover, this expenditure is an upper limit as the assumption has been made that anyone who is eligible also participates in the programme and that the size of the informal sector in the non-agricultural sectors is likely to decline over time.

Job guarantee and public works programmes have a long history. Since the 1960s and early 1970s, a range of labour-intensive public works programmes have been implemented in the Asia-Pacific region...
as a policy instrument to create employment and address poverty (see box 4.1).

**Providing income security for the elderly**

There are several non-contributory pensions in the region. In many of them, however, the age requirement is relatively high – especially when compared to life-expectancy. A further shortcoming of many schemes is that participants receive low benefits – often too low to provide for even a minimum standard of living. In Nepal, for instance, benefits were initially equivalent to approximately only 10% of GDP per capita (they have since been raised to approximately 25% of GDP per capita). In Thailand, the monthly pension is about two-thirds below the national poverty line, while a means-tested benefit for the elderly in the Republic of Korea is equivalent to only about 5% of the average wage.

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**Box 4.1. Programmes to foster employment**

In the Asia-Pacific region, important job guarantee schemes targeting vulnerable groups have been introduced. In India, for instance, the Mahatma Gandhi National Rural Employment Guarantee Act has operated since 2005. This Act extends a guarantee of employment for 100 days to every rural household within a programme district that has an adult willing to work as casual labour at the minimum wage, and has become the largest employment programme in the world, supplying nearly 53 million rural households with employment in the fiscal year 2009/10. Similar schemes have also been introduced in Bangladesh, the largest of which is the “Employment Generation for the Hard-Core Poor”. This scheme also provides 100 days of employment, but targets primarily the extremely “hardcore” poor who have no assets, are completely or seasonally unemployed, are marginal farmers or are otherwise excluded from any other social safety net programme. *Padat Karya*, a labour intensive employment programme existed in Indonesia between 1987 and 1994 to create jobs through workers’ engagement in public works. The programme was reintroduced in the wake of the 1997-98 economic crisis. Due to the urban nature of the crisis, initially the programme was introduced in the urban areas, but some rural areas were also covered later following crop failures. These programmes were available only to the unemployed who were willing to accept lower wages. The kind of activities included in the programme were repairing roads, flood plains and irrigation systems and cultivating fallow land. Participants earned, on an average, 27,500 Indonesian rupiah (Rp) ($2.82) per month, as the programme provided an average of only 4.5 man-days of employment per month to participating households. Nevertheless, these job guarantee schemes have had an important impact on poverty by creating a social safety net for informal workers. They have also strengthened rural growth by improving the resource base of the rural economy and providing important agricultural infrastructure.

It is important to note that providing employment for skilled workers in the formal sector is also vital to foster sustainable and inclusive development. Moreover, special attention should be given to well-designed active labour market programmes (ALMP) that combat youth unemployment, which is significantly higher than unemployment for the labour force at large.

AMLPs are usually implemented for the following reasons: to increase labour demand; to enhance the supply of labour; and to improve the functioning of the labour market. One element to increase demand is to reduce the cost of labour and foster employment growth by granting employment subsidies. For instance, in response to the global economic crisis, Turkey introduced wage subsidies by publicly financing social security contributions paid by the employer for a period of up to 54 months for newly hired workers, depending on the age, status and qualifications level of the employee. By doing so, more than 125,000 new young (aged 18-29) workers were employed in 2009 and 2010. Moreover, an additional 140,000 employees who had previously been unemployed for more than 3 months also found employment in 2009 and 2010 (ILO and OECD, 2011). Tax reforms can also be initiated to encourage job creation. For instance, in the Republic of Korea, tax credits have been introduced to offset the burden of social security premiums created by employment growth for small and medium enterprises (SMEs), while youth that are employed by SMEs are exempt from paying income taxes for up to three years (ILO, 2012h).
Box 4.1. (continued)

As highlighted by the call for action on the youth employment crisis that was adopted at the International Labour Conference in June 2012, there is an urgent need to improve links between education, training and the world of work. Also, governments need to improve the range and types of enhanced technical vocational education and training, including apprenticeships, other work-experience schemes and work-based learning to foster youth employment (ILO, 2012i). In the European Union, for instance, some AMLPs to enhance the supply of labour have taken the form of youth guarantee programmes. A number of these have been implemented in response to the impact of the global economic crisis on youth unemployment. For example, young people of Sweden are now offered youth specific activities after 90 days of unemployment. These activities include educational and vocational guidance as well as coaching on job search activities. They are then combined with work experience, education and training grants to business start-ups and employability rehabilitation efforts. In Finland, intervention occurs earlier, immediately upon registering as unemployed. Within a three-month period, each youth has to be placed in either a job or be receiving some form of education. The success rate of this youth guarantee scheme related to reducing unemployment and inactivity is estimated at more than 80% (ILO, 2012c). Similar AMLPs have been adopted in Asia and the Pacific. In New Zealand, for example, the purpose of an initiative entitled “Youth Guarantee” is to increase the educational achievement of targeted 16 and 17 year olds to improve transitions between school, tertiary education and work.

Indeed, anticipating future skills needs is a critical element of strong training and skills strategies. For instance, the development success of the Republic of Korea has been in part attributed to a government-led skills development system that has been designed to ensure that the skills of the workforce coincide with the skills of industry. A fundamental aspect of it has been to invest in a well-educated and highly skilled workforce.

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The proposal is to introduce a pension scheme that has reasonable eligibility requirements in terms of age, and that delivers sufficiently high benefits to avoid falling into poverty

The proposal is therefore to introduce a pension scheme that has reasonable eligibility requirements in terms of age, and that delivers sufficiently high benefits to avoid falling into poverty. Specifically, the proposal is to grant benefits which are equivalent to the national poverty line in each country to all persons aged 65 and above. Moreover, with large proportions of the labour force in the region engaged in the informal sector, any broad-based pension scheme that aims to provide a minimum level of income security must be universal and non-contributory, so that receiving a benefit is not conditional upon having contributed to a pension scheme when working. This is especially important for women or persons with disabilities who have had limited access to formal employment. Administration costs equivalent to 5% of the total pension expenditure has been added.

The expenditure to provide a universal, non-contributory pension for all persons aged 65 or older in 10 countries in the region is shown in Figure 4.4. The variation between countries is determined by the proportion of older people in the population and in how far the respective national poverty line compares to GDP per capita. For the majority of countries, the expenditure is very affordable, ranging between 1 and 4% of GDP by 2030. In some countries, population dynamics will lead to a more rapid increase in expenditure to finance a universal non-contributory pension. For
instance, in Malaysia, the relative expenditure of universal pension will more than double as the proportion of the population aged 65 and older will also double between 2012 and 2030; in China, Fiji, Indonesia, the Philippines, Thailand and Turkey, the expenditure will increase by more than 75%.

Moreover, expenditure will increase beyond 2030 in the countries analysed. In the Russian Federation, a plateau of 2.6% of GDP would be reached by 2055, after which the expenditure would decline as the proportion of the population aged 65 and above decreases; in Thailand expenditure would reach 4.15% of GDP before declining after 2075, based on current estimates of population dynamics.

This indicates that while the introduction of a non-contributory pension would be an important element in providing a social protection floor, governments should introduce additional pillars of pensions and may eventually have to introduce a means-test (or reduce benefits) to keep expenditure under control.

Providing income security for persons with disabilities

To estimate the expenditure to provide disability benefits that would bring beneficiaries to the national poverty line in their respective country to all persons with disabilities between the age of 15 and 65, data provided in the World Report on Disability (WHO, 2011) and results of the Global Burden of Disease Survey 2004 by main regions were used (see annex). Overall, the expenditure to provide such disability benefits ranges between 0.14% of GDP in China to 0.87% of GDP in Bangladesh (see figure 4.5).

Providing health for all

With an appropriate health-financing strategy (see box 4.2), the World Health Organization (WHO) estimates that 15-20% of out-of-pocket expenditure as a share of total health expenditure and 5 to 6% of government expenditure on health as a share of GDP are required to considerably reduce the incidence of incurring a financial catastrophe at the household level. So far, most countries in the region are far from reaching this goal. Public expenditure on health in Myanmar amounted, for instance, to less than a quarter of a per cent of GDP in 2009 (see figure 4.6).

In many countries, reaching the WHO benchmark of 5% by 2030 will require significant effort: for instance, in Bangladesh public expenditure on health
would need to increase by 9% annually to reach the goal. In contrast, the effort required in other countries will be considerably less: in Turkey, the goal has already been reached and in Thailand, expenditure would need to increase by less than 2.5% per year to reach the target rate of 5% of GDP by 2030. As the required percentage increase differs by country, yet remains constant per country until the target date, the additional absolute increase in health expenditure will accelerate as the target date of 2030 approaches.

Levels of expenditure on health are, of course, only one way of capturing progress towards implementing universal health coverage. Moreover, health costs alone do not take efficiency of expenditure into account. For instance, a number of countries in the region already spend significantly more than 5% of their GDP on health, but are far from achieving universal coverage.4 At the same time, Thailand, which spends less than 5% of its GDP on health, is largely viewed as having achieved universal coverage of health services. Greater health expenditure should, therefore, go hand-in-hand with efforts to address the significant disparities that exist within countries in terms of health outcomes to capture inefficiencies and ensure that access to health care is universal and equitable.
Both a fundamental right and an investment in human capital, universal health coverage is a widely established objective in the Asia-Pacific region. In order to achieve appropriate preventive, curative, rehabilitative and palliative services at an affordable cost, countries need to advance along three dimensions: the breadth or extension of the population coverage by insurance schemes; the depth or the types of services that need to be provided, such as outpatient and inpatient services; and the height or the financial risk protection, such as co-payments (Tangcharoensathien and others, 2011).

The global economic recession has put stress on health-care budgets and is generating greater vulnerability, especially among the poor and marginalized segments of the population. Current levels of out-of-pocket health expenditure in the Asia-Pacific region are much higher than in other parts of the world. In a high number of cases, households incur catastrophic health expenditures. Moreover, in many countries, government spending on health is too low to sustainably finance universal coverage. Behind this limited fiscal space is a low tax-base and insufficient progressivity of the tax structure.

Given these constraints, governments in the region face the dilemma of negotiating two paths: providing a high level of services and financial protection for a small group of the population versus extending a high level of population coverage but with restricted services and financial protection.

To achieve greater policy space for negotiating this trade-off, governments can expand health services, especially for primary health care, by increasing financial resources and achieving greater efficiency in use of resources. Prepayment and risk-pooling arrangements can also allow for the extension of services to more people and for the reduction of out-of-pocket payments, and, thus, catastrophic health expenditure.

Against this backdrop, the WHO has proposed a health financing strategy to assist Member States in achieving universal coverage (WHO, 2009a). This framework is adapted to national contexts in collaboration with ministries of health and relevant national health-care stakeholders. The strategy identifies eight priority areas that countries in the region will need to focus on, as they move from “out-of-pocket” dominated health protection to universal coverage that would include tax-based financing, social health insurance and a mix of other prepayment schemes including private insurance.

1. Increasing investment and public spending on health: With the aim of ensuring adequate public financing, this strategy calls for increased government financial commitment to health care in medium- and long-term plans of action and for multi-sectoral synergy and coordination.

2. Improving aid effectiveness for health: Given that external aid will continue to serve as a key source of financing in many Asian and Pacific countries, it is essential to better align overseas development assistance (ODA) with national health programmes and objectives.

3. Improving efficiency by rationalizing health expenditures: Resources should be outcome-based and address inequities, inefficiencies and low service quality. All planning should be oriented towards the goal of achieving universal coverage through balanced allocations between primary, secondary and tertiary care.

4. Increasing the use of prepayment and risk-pooling: Prepayment and risk-pooling arrangements can improve equity, access and protection against the financial risks of ill-health. The advantage of these arrangements is that they offer adequate options, such as social health insurance, with equitable contributions and benefits.

**Box 4.2. The WHO Health Financing Strategy for the Asia-Pacific region**
Box 4.2. (continued)

(5) Improving provider payment methods: Pride of place should be given to provider payments, as a market mechanism for improving the allocation of health resources. Influencing consumer and provider behaviour can orient the mix of the delivery of services as well as contain supply-side costs and modify consumer demand.

(6) Strengthening safety-net mechanisms for the poor and vulnerable: Measures should be taken to enhance and expand social safety-net mechanisms in order to reduce cultural, economic, social and political barriers that exclude vulnerable populations from accessing health services.

(7) Improving evidence and information for policymaking: Integrating quality data into routine health information systems can facilitate decision-making. Identifying data and quality gaps and developing research capacity is also important for generating ongoing information needs.

(8) Improving monitoring and evaluation of policy changes: Government can establish mechanisms for monitoring and evaluating the implementation process. Toward this end, they can incorporate health-financing indicators into an overall health-monitoring and evaluation framework and develop participatory, multi-stakeholder monitoring and evaluation, and link monitoring and evaluation to policy review by providing timely reports to health planners.

The following targets have been proposed to monitor and evaluate the progress made in achieving these eight strategies:

- out-of-pocket spending should not exceed 30-40% of total health expenditure
- total health expenditure should be at a minimum 5-6% of GDP
- more than 90% of the population should be covered by prepayment and risk-pooling schemes
- close to 100% coverage of vulnerable populations should be achieved through social assistance and safety-net programmes

Several countries in the region are successfully using this health financing strategy to hone in on challenges and capitalize on opportunities concerning achieving universal coverage. The instrument used to establish this partnership is the Country Cooperation Strategy, a medium-term framework between the WHO and the country in question. WHO has such strategies with, for example, Afghanistan, Malaysia, Mongolia, Nepal and Sri Lanka.

Providing education for all

The aim is to calculate the additional expenditure required to attain universal enrolment in primary education in the region by 2020 and in secondary education by 2030. Many countries in the region have already reached universal primary enrolment, including, among others, China, Fiji, and Turkey. In others, primary enrolment rates are already high, such that the additional expenditure required to reach universality is likely to be low.

Based upon the assumption that governments would need to linearly scale up their expenditure on education to provide the resources needed to capture those that are not yet enrolled in primary and secondary school, figure 4.7 shows the additional expenditure that governments would need to incur to achieve universal primary enrolment by 2020 and universal secondary enrolment by 2030. As Malaysia, for instance, has almost achieved universal primary enrolment, the additional expenditure to bring those not enrolled into school is relatively small, amounting to just over two hundredths of a percent of GDP. In contrast, with an enrolment rate in secondary school of approximately 68%, additional expenditure to achieve universal secondary enrolment would amount to 0.9% of GDP by 2030.
INVESTING IN INCLUSIVE AND SUSTAINABLE DEVELOPMENT

These expenditure estimates are based on the assumption that public expenditure on education can be scaled up linearly to capture those children that currently fall outside the primary and secondary school system.

A new United Nations initiative, “Education First”, valued at $1.5 billion was launched in September 2012

A new United Nations initiative, “Education First”, valued at $1.5 billion was launched in September 2012 to give a new impetus to put every child in school and to increase the quality of education by the 2015 target date. Indeed, initiatives that are aimed at high-quality schooling have come to complement, and, in some contexts, have even begun to replace the earlier focus on school access and education expansion. It is laudable that the nine most highly-populated developing countries adopted in December 2012 the New Delhi Commitment, which is aimed at achieving “inclusive, relevant [and] quality education for all”. In particular, the countries recognized that existing policies, strategies and interventions to address more effectively concerns of equity in education systems needed to be improved. Part of this involved improving working conditions of teachers, such as by addressing low public wages in teaching. A further important component would entail making education more relevant to the social and cultural context and to people’s lives.

However, there is increasing acknowledgement that providing financial resources alone will not improve pedagogical outcomes if educators are not performing as expected. To increase the accountability of teachers, countries in the Asia-Pacific region have begun decentralizing control of schools to local communities. A study that measured the impact of such policies in the three Indian states of Karnataka, Madhya Pradesh, and Uttar Pradesh detected positive improvement in teachers’ attendance, the participation of parents in school life, and students’ interest concerning resources, such as scholarships, uniforms, and books (Pandey, Goyal and Sundararaman, 2009). Box 4.3 presents selected best practices in the region for improving quality of education.

Providing energy access for all

The expenditure estimation of providing sustainable energy along the lines of the Sustainable Energy for All initiative, includes three components: (i) ensuring universal access to modern energy services; (ii) doubling the global rate of improvement in energy efficiency; and (iii) doubling the share of renewable energy in the global energy mix. Sustainable Energy for All is a global initiative launched by the United Nations Secretary-General with the aim to make sustainable energy for all a reality by 2030. It is estimated that a total investment of about $1 trillion ($979 billion) would be required to achieve universal energy access by 2030, an average of $49 billion.
Box 4.3. Selected best practices and good examples on education policy

Skills at 15: A good practice in assessing the quality of education

Good quality education prepares students to effectively function in society. According to the Dakar Framework for Action, it helps all students achieve “measurable learning outcomes […], especially in literacy, numeracy and essential life skills”. However, measuring quality of education is not an easy task. Benchmarks and quality of data across countries vary significantly. Globally established indicators are also lacking. To date, the most effective measure of education quality is the Programme for International Student Assessment (PISA). Initiated by the Organisation for Economic Co-operation and Development, the programme assesses 15-year old students in these exact skills: reading (including ability to retrieve, interpret and evaluate), mathematics and science.

Fifteen countries from the Asia-Pacific region participated in the 2009 PISA. The results were striking. Students from developed countries, particularly those in North and North-East Asia not only scored better than those in developing countries, but were also significantly above the OECD average. On the contrary, developing economies and countries in transition were among the lowest performers.

PISA is not designed to provide policy recommendations. The survey results, however, show a strong positive correlation between students’ performance and governments’ efforts to attract and retain the best teachers. Surprisingly, the results have found no correlation between performance and early orientation of students towards either traditional academic or technical and vocational tracks.

Skills at 22: Bridging the gap between demand and supply of practical skills in India

Quality of education is also a concern at the tertiary level. Hiring managers face difficulties in finding suitable candidates for available jobs, even among university graduates. In a survey, 53% of employers in India indicated that the leading reason behind unfilled entry-level positions was the lack of applicants with the skills needed to carry out the functions of the job (McKinsey, 2012). Similarly, only 54% of Indian youth believed that their post-secondary studies improved their employment opportunities. Inequality also plays a role in creating this gap. Although the country’s elite management schools and engineering colleges are globally recognized, students from lower socioeconomic backgrounds are less likely to have access to these institutions.

In response, initiatives to help build skills among Indian youth have emerged from non-state actors. Pratham is a non-governmental organization (NGO) that focuses on offering high-quality education to underprivileged students. Through its vocational skills programme, more than 2,300 youth have received vocational skills training, while another 14,000 have participated in basic computer literacy courses. The vocational skills training focuses on market-relevant courses, such as agriculture, banking and hospitality. Trained youth have also received support to start their own business.

Infrastructure Leasing & Financial Services Limited (IL&FS), a private infrastructure services firm in India, is also investing heavily in building skills among young people. The Skills Initiative Group within the company not only provides skills training for disadvantaged youth in rural areas, but also helps place them in appropriate jobs. With the support of the Ministry of Rural Development, the programme boasts to have trained and placed more than 2,000,000 rural youth living below the poverty line in jobs.

A child-centred, rights-based approach in the Lao People’s Democratic Republic

In the Lao People’s Democratic Republic, the Ministry of Education, with the support of the United Nations Children’s Fund (UNICEF), established the “Schools of Quality” programme, which has been included in the Education Sector Development
Box 4.3. (continued)

Framework 2009-2015. The programme has two primary goals: to increase the enrolment and completion ratios of primary education; and to improve the quality of teaching, so as to realize children's full potential. Providing a healthy, clean, safe and protective environment is the central objective of this approach.

The programme focuses on practical training for teachers and school principals, implementation of school self-assessment based on established minimum standards and indicators, infrastructure improvements, with a focus on safe water and sanitation, and availability of teaching materials. The programme relies on the support of provincial and district administrators and on supportive engagement of communities to ensure that all children attend school.

The upfront cost of implementing the physical improvements is estimated to be about $10,000 per school, plus an additional $400-500 per year for operating costs and school materials. Although the programme was piloted in high-capacity communities, it has since expanded to poorer or more challenging environments, targeting ethnic minorities and actively reaching out to girls.

Although still new, the outcomes of the programme are already visible. More than 200,000 boys and girls are currently enrolled in participating schools. School principals and teachers are better equipped to perform their tasks and can take pride in the improvements. Setting realistic goals and standards has also helped bring about a sense of accomplishment and motivation among those participating in the initiative.

The rigorous system for teacher evaluation and compensation in Singapore

Providing the right incentives is central to attracting top quality educators. Singapore is a pioneer in the region in placing teacher evaluation and compensation at the core of its education policy.

Strict selection criteria ensure that only top school performers have the opportunity to become teachers. This selection rigour contributes to the high respect accorded to the profession. All teachers are trained at the National Institute of Education (NIE), but the majority of applicants have already completed a bachelor's degree in the subject they are going to teach before entering a teacher education programme.

Compensation is also high enough to not be considered a disincentive for prospective young teachers. Over his or her career, a teacher is also eligible for bonuses, which are awarded on the basis of a sophisticated teachers’ appraisal system. The appraisal system consists of 16 areas that teachers are evaluated on annually, including contributions they make to the school and the community.

Professional development is also attended to. All teachers are observed during the first three years of their career to determine whether they would be best suited for the teaching track, the leadership track or the specialist track. In 2012, the Ministry of Education launched the Teacher Growth Model, a professional development model which encourages teachers to engage in continuous learning and take ownership of their progress.

Improving quality of textbooks in the Republic of Korea

Working with relevant curricula and school materials is essential to fulfilling the potential of both teachers and students. Bolstered by high Internet penetration throughout the country, the Ministry of Education, Science and Technology, Republic of Korea, has initiated a programme to convert existing textbooks into digital books and to create a networked database of instruction materials for teachers.
The textbook prototypes were first introduced to elementary schools throughout the country on a pilot basis. In contrast to traditional textbooks that rely on repetition for learning, senior educators in the country consider that digital tools, such as personal computers (PCs) and tablets, are more appropriate for the application of knowledge and for boosting creativity among students. Digital textbooks can encompass dynamic content – and are also easier to update by teachers.

In implementing this initiative, the Republic of Korea was at an advantage. Fast and reliable Internet connections across the country, a history of support for technology in schools and the ability to use and create technology were unique conditions that enabled this innovative transition. The initial cost of the programme, estimated at about $2.4 billion, indicated the strong commitment of the Government to invest in its youth.

Investment needs for universal energy services should consider accessibility, adequacy and affordability of the process

Efforts to understand the regional expenditure estimates of providing universal energy services should incorporate multiple factors including accessibility, adequacy and affordability of the process. In this particular exercise, expenditure estimates are based primarily in terms of providing universal access of modern energy services in two areas: electricity and modern cooking. By providing access to electricity, national development plans can be put in place to source energy from renewable sources, such as solar, wind and geothermal, as well as to improve energy efficiency.

The expenditure required to provide universal access to energy services is calculated on the assumption that there will be universal access to modern energy services by 2030, such as to electricity and modern cooking fuels. The United Nations Secretary-General's Advisory Group on Energy and Climate Change (AGECC) has suggested using a “basic human needs” approach to identify the costs for universal energy access services, including access to electricity for lighting, health, education, communication and community services (50-100 kilowatt hours per person per year) and access to modern fuels and technologies for cooking and heating (50-100 kilograms of oil equivalent of modern fuel or improved biomass cook stove) (United Nations, 2010). Moreover, other studies suggest that access to electricity for the entire population implies that the initial threshold level of electricity consumption for rural households be 250 kilowatt-hours (kWh) per year and 500 kWh per year for urban households. In the case of access to modern fuel, it suggests providing access for all households to biogas...
systems, liquefied petroleum gas (LPG) stoves and advanced biomass cook-stoves, as these modern cooking facilities have considerably lower emissions and higher efficiencies than traditional sources of cooking facilities (IEA, 2011).

The annual investment for achieving universal access to energy varies significantly

Given that the availability of access to modern energy sources varies across the countries in the region, the investment requirements vary accordingly. Investment requirements to provide universal access to electricity and modern cooking fuels, have been calculated for Bangladesh, Cambodia, China, Fiji, India, Indonesia, Malaysia, the Philippines, Thailand and Turkey. The annual additional investment for achieving universal access to modern energy services by 2030 in these countries varies significantly given the existing status of access to energy services, the geographical size of the country, and existing grid connections as well as the production and energy sources mix.

The average annual additional investment requirement ranges from about 3% of GDP in Bangladesh, to 0.38% GDP in Turkey (see figure 4.8). The relatively high investment need in Bangladesh is mostly due to lack of availability of modern cooking fuel facilities and access to electricity in rural areas. The proportion of the population that has access to these facilities is considerably lower than in other countries. No additional investment is required in the case of the Russian Federation given that it has already reached universal access to energy.

In the case of Fiji, the investments associated with expanding energy access are also substantial. While access to modern cooking fuel in rural areas is limited, the country’s remoteness raises costs.

Policymakers should recognize that the investment requirements significantly depend on (i) the period of implementation, (ii) the potential of technological improvements, (iii) the use of renewable sources in the energy mix and (iv) the increase in energy efficiency. Therefore, investment requirements are expected to improve over time due to enhanced services infrastructure and capacity development projects. Box 4.4 outlines the energy policy in Nepal, for instance, a country with extremely low rates of electricity consumption.
Box 4.4. Energy policy in Nepal

Nepal is a landlocked mountainous country covering a total area of 147,181 km². More than 30% of the country’s population of 29 million live below the national poverty line. Nepal has experienced rapid political change in the last two decades, which has also been marked by the end of a long conflict in 2006. Amid the ongoing transition to democracy, the Government of Nepal faces high expectations regarding the development agenda, including the provision of energy infrastructure.

Nepal has one of the world’s lowest rates of per capita electricity consumption. More than 80% of the population lives in rural areas, where poverty, remoteness and difficult topography present challenges in providing modern energy services. In addition, there is a general lack of trained people to install, operate and maintain energy systems in such areas. In rural Nepal, 89% of the consumed energy comes from the traditional use of biomass, and in 2006, only 16% of the population had access to modern fuels for cooking and heating. In 2008, about 40% of the country’s population had access to electricity, with rural electrification at 29%.\(^a\) Due to the ongoing efforts of the Government and various development partners, 55% of the total population now has access to electricity.

Research by the Alternative Energy Promotion Centre (AEPC), a government institution under the Ministry of Environment and United Nations Development Programme (UNDP) found that improved access to electricity in rural areas led to an 8% increase in household incomes in 2009; reduced average annual spending on energy by non-electrified households from $41 to $19; and resulted in the creation of 40 new businesses for every new micro hydropower station brought on line.\(^b\)

The Government of Nepal recognizes that access to clean and reliable energy contributes to rural poverty reduction and environmental conservation\(^c\) and thus has set a national vision of “Electricity for all by 2027”.

To support its national vision, the Government has put together a comprehensive set of policies to enable various stakeholders to work cohesively. In 2001, Nepal launched the Hydropower Development Policy 2001\(^d\) to tap the economically viable hydropower potential of 42,000 MW. Thus far, it is estimated that only 1% of this potential has been developed.\(^e\) In 2006, the Rural Energy Policy noted that “Rural Energy” means energy that is environmentally friendly and used for rural households’ economic and social purposes. Under this policy, the broadened resource base includes, among other things, micro and mini hydro, solar energy, wind energy and biomass energy. Recognizing the lack of credit available for rural energy projects, the Subsidy Policy for Rural Energy (SPRE) proposed in 2009 the establishment of an institutional long-term credit mechanism under the Rural Energy Fund (REF) to supervise and disburse direct cash subsidies.

Furthermore, during the ninth development plan, the Government encouraged private sector participation in the energy sector. This was done in response to constraints on the public sector in meeting the growing domestic demand for electricity and to better exploit the export potential of electricity. As a result, power purchase agreements between independent power producers and the Nepal Electricity Authority (NEA) through various contracts now constitute 25% of total supply in the country. In addition, United Nations initiatives to use public-private partnerships (PPPs) for urban environment remain popular in the areas of water, sanitation and waste management, which has implications in the renewable energy area.\(^f\)

In order to streamline its efforts to achieve the national vision of “Electricity for all by 2027”, AEPC has recently initiated a nationwide umbrella program titled the “National Rural and Renewable Energy Program (NRREP)” that runs until 2017. The objective of the programme is to improve the living standards of the rural people, increase employment as well as productivity, reduce dependency on traditional energy and attain sustainable development by integrating alternative energy with the socioeconomic activities of women and men in rural communities. NRREP is designed in a single-modality approach with three components:
Box 4.4. (continued)

“Central Renewable Energy Fund (CREF), “Technical Support and Business Development for Renewable Energy” and “Productive Energy Use”. This single-modality approach enables the implementation of each component of this programme in partnership with various organizations in rural areas of Nepal.

a UNDP (2012).
e Ibid.

INVESTMENT AND EXPENDITURE FOR INCLUSIVE AND SUSTAINABLE DEVELOPMENT

The overall investment and expenditure for providing a job guarantee, ensuring universal access to education and health services, providing disability benefits and an old-age pension system and extending universal access to modern sources of energy would amount to 2.6% of GDP in China if implemented fully in 2013. These required investments would increase to 3.3% of GDP in 2020 and reach 5.2% by 2030, when all goals would be met. In the Asia-Pacific countries, with the exception of Bangladesh and Fiji, the required investments would remain under 10% of GDP throughout the period to 2030, with estimates for Indonesia, Malaysia, the Russian Federation, Thailand, and Turkey, ranging between 5 and 8% of GDP (see figure 4.9).

These amounts are not trivial. For Bangladesh, which is classified as a least developed country, the challenge of raising more than a fifth of GDP would only be achieved with significant external assistance.9 The smallness of Fiji clearly sets limits for it to benefit from economies of scale. In the case of the other economies, the additional expenditure may also be significant. In India, for instance, extra spending of about 9% of GDP would translate into an increase in government spending by almost a third.

Yet, general government expenditures in the Asia-Pacific region are lower than the world average. As a share of GDP, they represented 38.1% of GDP in 2010 compared to 42.4% for North America and 50.9% for the 15 countries of the European Union (see table 4.1). The only large country in the region with a relatively high level of government expenditures as a share of GDP is Japan (54.4%).

A lower share of government expenditure in the GDP of Asia-Pacific countries could be due to their lower average level of development. This is reflected in the data by a positive relationship between the share of government expenditures in GDP and GDP per capita (see figure 4.10).10 Two clusters are evident in this figure: one of high-income countries outside the region with high levels of general government expenditures, and another with a majority of the countries from the Asia-Pacific region, characterized by lower GDP per capita and a lower share of general government expenditures in GDP.

Moreover, most Asia-Pacific countries are at or below the average for countries with similar levels of GDP per capita (shown by the line in the scatter plot). This is the case for high-income economies in the region, such as Australia; Hong Kong, China; New Zealand and the Republic of Korea, and for lower-income countries, such as Armenia, China, India, Kazakhstan and Thailand. This suggests that higher government investment and expenditure would be
Figure 4.9. Total investment and expenditure for proposed policy package

Source: ESCAP.

Notes: For Turkey, data on public expenditure on primary and secondary school expenditure are unavailable and not included in the graph. As access to energy is already universal in the Russian Federation, no additional investment is required for this indicator.
feasible to finance, for instance, the proposed policy actions outlined above, comprising employment for all, income security for the elderly and for persons with disabilities, and health, education and energy access for all.

Moreover, data also suggest that many Asia-Pacific countries have fiscal space to finance this expenditure by enhancing their efforts to raise tax revenue. Thus, general government revenue for the region as a whole was equivalent to 34.4% of GDP in 2010, compared to 44.7% in Europe.\(^1\)

In particular, the fact that a number of countries that are not resource rich are able to raise more revenue for similar levels of GDP per capita than others (see figure 4.10), suggests that greater efforts could mobilize more tax revenue to be used to finance the investment and expenditure required for more inclusive and sustainable development. Broadening tax bases and making tax structures more progressive would be a first step towards mobilizing more revenues. In addition, improving the efficiency of tax administration and other creative revenue policies could be implemented to increase available resources.

### MACROECONOMIC IMPLICATIONS

An important issue is whether countries can afford the investment and expenditure required for inclusive and sustainable development while maintaining fiscal sustainability and price stability. This hinges on whether growth dividends from increased government expenditures will be sufficiently large enough to keep public debt at a manageable level, and the extent to which greater expenditure and higher output growth will push up price levels. Using a long-term macroeconomic simulation exercise, in this section, it is argued that inclusive and sustainable development alongside fiscal sustainability and price

<table>
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<tr>
<th>Table 4.1. General Government expenditure and revenue</th>
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<td><strong>Country / Region</strong></td>
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<td>Armenia</td>
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<td>Australia</td>
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<td>Azerbaijan</td>
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<td>Bangladesh*</td>
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<td>China</td>
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<td>Fiji*,+</td>
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<td>Georgia</td>
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<td>Hong Kong, China</td>
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<td>India</td>
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<td>Indonesia*</td>
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<td>Iran (Islamic Rep. of)</td>
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<td>Japan</td>
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<td>Asia and the Pacific</td>
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<td>EU-15</td>
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Source: ESCAP, based on data from International Monetary Fund, Government Finance Statistics.

Notes: * Refers to central government figures as no general government figures are available; + based on data from Asian Development Bank, Key Indicators for Asia and the Pacific 2012. Figures for aggregates are weighted averages based on nominal GDP weights. Asia and the Pacific includes Afghanistan; Armenia; Australia; Bhutan; China; Georgia; India; Iran (Islamic Republic); Japan; Kazakhstan; Maldives; Mongolia; New Zealand; Republic of Korea; Russian Federation; Hong Kong, China; and Macao, China.; EU-15 includes Austria; Belgium; Denmark; Finland; France; Germany; Greece; Ireland; Italy; Luxembourg; Netherlands; Portugal; Spain; and Sweden. The rest of the world includes Belarus; Bosnia and Herzegovina; Brazil; Bulgaria; Canada; Chile; Costa Rica; Cyprus; Czech Republic; Egypt; El Salvador; Estonia; Honduras; Hungary; Iraq; Saint Kitts and Nevis; Latvia; Lesotho; Lithuania; Macedonia; Malta; Mauritius; Morocco; Norway; Poland; Paraguay; Republic of Moldova; Romania; Serbia; Slovakia; Slovenia; Switzerland; Seychelles; Ukraine; and South Africa.
Figure 4.10. Relationship between government expenditures and GDP per capita, 2005-2007

Source: ESCAP, based on data from International Monetary Fund, Government Finance Statistics.

Note: The fitted line is based on a weighted least squares regression in which the weights represent PPP-adjusted GDP at constant 2005 international $. The size of the bubbles represents PPP-adjusted GDP, and the colour shows country groupings: green for Asia and the Pacific; brown for the EU-15; and blue for the rest of the world. Country codes - countries and areas of the ESCAP region are available in the explanatory note. - non-ESCAP members; names and codes are as follows: AUT - Austria; BEL - Belgium; BGR - Bulgaria; BiH - Bosnia and Herzegovina; BLR - Belarus; BRA - Brazil; CAN - Canada; CHE - Switzerland; CHL - Chile; CRI - Costa Rica; CZE - Czech Republic; DEU - Germany; DNK - Denmark; EGY - Egypt; ESP - Spain; EST - Estonia; FIN - Finland; FRA - France; GBR - United Kingdom of Great Britain and Northern Ireland; GRC - Greece; HND - Honduras; HUN - Hungary; IRL - Ireland; IRQ - Iraq; ISL - Iceland; ITA - Italy; KNA - Saint Kitts and Nevis; LSO - Lesotho; LTU - Lithuania; LVA - Latvia; MAR - Morocco; MDA - Republic of Moldova; MKD - The former Yugoslav Republic of Macedonia; MLT - Malta; MUS - Mauritius; NLD - Netherlands; NOR - Norway; PER - Peru; POL - Poland; PRT - Portugal; PRY - Paraguay; ROU - Romania; SLV - El Salvador; SRB - Serbia; SVK - Slovakia; SVN - Slovenia; SWE - Sweden; SYC - Seychelles; UKR - Ukraine; USA - United States of America; and ZAF - South Africa.

Figure 4.11. Relationship between government revenues and GDP per capita, 2005-2007

Source: ESCAP, based on data from International Monetary Fund, Government Finance Statistics.

Note: See notes for figure 4.10.
stability can be achieved as long as policies are designed carefully and implementation is effective.

Inclusive and sustainable development alongside fiscal sustainability and price stability can be achieved

The simulation exercise analyses the impact of greater public investment on the trajectories of public debt and price levels. In addition to the direct impact of additional public investment on output growth, the analysis takes into account the macroeconomic spillover effects of the increased spending. These indirect impacts take the form of greater labour force participation, higher wage earnings of newly hired workers and greater labour productivity. Additional public spending affects government consumption and fixed investment through, for instance, various projects to expand and maintain access to energy and public services in lagging areas. As a result, total factor productivity benefits from innovative ideas and knowledge exchanges made possible by a larger pool of educated and healthy workers. At the same time, private domestic investment, merchandise imports and population growth are also affected. Depending on the extent to which these indirect impacts are generated by fiscal expenditure, three likely scenarios are depicted, in the analysis which covers eight of the ten Asia-Pacific economies for the period 2013-2030 and for which expenditure investment estimates for inclusive and sustainable development are elaborated above.

Debt sustainability

The future public debt paths shown in figure 15 are generally sustainable. In India, the Russian Federation, Thailand and Turkey, public indebtedness rises after the introduction of the inclusive and sustainable development framework if the indirect impacts of the framework for inclusive and sustainable development are relatively weak (“small macro spillovers” scenario). The debt ratio declines steadily, however, once the indirect impact of greater expenditure to strengthen health, education, energy and income security takes effect and output growth accelerates. As economic growth is fuelled by both fiscal injections and more favourable macroeconomic structure, debt ratios decline to levels close to those observed in 2012. As expected, in these economies, debt ratios fall more steeply if the indirect impacts are stronger, such as under the “moderate macro spillovers” scenario.

In other countries, the sustainability of public debt is conditional on a sizeable improvement in macroeconomic fundamentals. Thus, in Indonesia, Malaysia and the Philippines, public debt displays an increasing trend under the scenarios that assume small or moderate macroeconomic-spillover effects. In these countries, the indirect impact of increased public spending on growth must be greater to secure fiscal sustainability, as depicted in the “large macro spillovers” scenario. Indeed, figure 4.12 shows that for these three economies, the average GDP growth rates over the period 2013-2030 under the “small” or “moderate” scenarios are only marginally higher than their baseline cases. This illustrates the importance of the quality of programme design and implementation in shaping the success of a policy shift towards inclusive and sustainable development.

The public debt path taken by China also exhibits an increasing trend under the “small macro spillovers” scenario but in terms of level (about 50% of GDP by 2030), this does not appear excessively high. The future upward trend is also in line with the baseline case.

Price stability

Inflation also remains manageable under the simulation scenarios considered here (see figure 4.14). In most cases, prices pressures either do not deviate much from the baseline cases or do not exceed the rates observed in the past decade. In cases in which price levels are projected to jump temporarily, such as in Indonesia and the Philippines under the “large macro spillovers” scenario, the rise is partly attributable to tight labour market conditions and higher worker earnings, and remains within an acceptable range, as highlighted in chapter 3.
Figure 4.12. Public debt

Source: ESCAP, based on the Oxford Global Economic Model.

Note: Baseline cases are projections made by the Oxford model when no shocks are imposed on any variables.
Individual earnings in real terms would typically improve as public services are universally provided.

Overall, the analysis in this section offers some encouraging messages. The future public debt paths for several Asia-Pacific economies seem sustainable if additional public spending is accompanied by stronger macroeconomic fundamentals, such as higher labour force participation rates, accelerated earnings and investment growth, and improved total factor productivity. While some economies will need larger macroeconomic-spillover effects than others, it is important to note that the assumed magnitude of improvements in the macroeconomic variables is not unrealistically ambitious, and should be achievable given the countries historical experiences.

For example, alongside the assumptions made on other macroeconomic variables, annual private domestic investment growth would need to reach 10.1% in Malaysia for debt to be sustainable in the future (“large macro spillovers”). This rate is in fact lower than that what was achieved during the period 2010-2012 (11.6%) and well below the rate observed in the decade prior to the Asian economic crisis of 1997-1998 (18.7%).

Similarly, for debt to be sustainable in the Philippines, individual earnings growth is assumed to range between 8.5 and 12.5% per year during the period to 2030 under the “large macro spillovers” scenario. This is far lower than the annual pace of 14.5% observed in the 1990s.

The policy implications are clear: a shift towards inclusive and sustainable development needs to focus on initiatives that help to enhance the potential growth to avoid public debt distress. Even the “moderate macro spillovers” scenario may not deliver desired outcomes in the long run in all economies. Government programmes need to be more quality-focused and growth-enhancing.

Among other things, this means, for instance, that education curricula must be relevant to countries so that students can learn to innovate and translate their human capital into higher wages. Similarly, health-care services must be adequate to keep the labour force productive. At the same time, energy sector development should help a country enhance its production efficiency and reduce its reliance on imported and traditional energy.
Figure 4.14. Annual change in GDP deflator

Source: ESCAP, based on the Oxford Global Economic Model.

Note: Baseline cases are projections made by the Oxford model when no shocks are imposed on any variables. The GDP deflator is used as a proxy of economy-wide price movements.
CONCLUDING REMARKS

In this chapter, it is shown that by using illustrative examples, the public investment required to create more inclusive and sustainable development is within reach of countries in the region, ranging between 5 and 8% of GDP by 2030 for half of the countries analysed here. Only for two countries would the investment and expenditure exceed 10% of GDP by 2030. In doing so, the analysis has not explicitly taken into account second-order linkages within an economy. For instance, providing universal access to clean and modern energy sources would have a positive impact on health indicators in the region, which would, in turn, lead to lower health expenditures, and thus free up resources that could be put to use elsewhere. Greater access to education would also affect health outcomes in a similar way. At the same time, improvements in education and health affect population growth. In such, the expenditure estimates provided in the chapter are an upper bound of what it would take to foster more inclusive and more sustainable development.

Even with modest assumptions, more inclusive and sustainable development would propel long-term development

Nevertheless, a number of challenges must be overcome in introducing the above-mentioned policy support measures to make growth more resilient, inclusive and sustainable. For instance, while in this chapter it is argued that greater expenditure is required to achieve universal enrolment in education, the issue of quality of education has been flagged. Similarly, while greater expenditure on health will widen access to health services, governments must address the need to increase the efficiency of their expenditure and the large disparities in the quality of health services.

Government’s capability and institutional factors also play an important role in implementing the policy measures outlined in this chapter to make development more inclusive and sustainable. In the chapter, it also is suggested that with relatively low expenditure-to-GDP ratios and tax revenue-to-GDP ratios in the region, greater efforts at domestic resource mobilization could raise the required financing. The findings discussed in this chapter show that even with modest assumptions on the impact of universal access to education, health and energy as well as increased income security on growth and labour productivity, greater investment and expenditure for more inclusive and sustainable development would propel long-term development.

Clearly, the examples used in the chapter are only illustrative to show how greater social protection, more income security and higher levels of energy sustainability could be achieved and that the investment expenditure for these programmes is affordable.

The argument for the universality of social protection and greater concern about environmental sustainability does not, however, imply homogeneity of mechanisms and/or “one-size fits all” public policy interventions. Rather, flexibility at the national level based on needs and capacities are required as governments design their programmes according to national economic constraints, political dynamics, social aspirations and the availability of resources. Thus, some countries may, depending on their national priorities, focus on a subset of the priorities presented in this chapter, while others may deem the need to implement them simultaneously more applicable.

Indeed, nowhere is this idea of developing a plurality of protection floors and staircases more germane than in Asia and the Pacific, where the striking diversity of the region necessarily implies that countries have different government support programmes and mechanisms in place and have different human development needs, fiscal space, and tradeoffs.

With continued weak growth prospects in developed economies, and the resulting impacts on developing countries, the investment and expenditure for developing a framework for inclusive and sustainable
development is especially critical in determining its political feasibility, particularly for least developed countries, which are experiencing lower demand for exports as well as lower inflows of ODA. However, coordinated actions, supported by regional cooperation, can address the challenges of resilient, inclusive and sustainable development. Investment and expenditure in jobs, education, health, protection of elderly and affordable modern energy sources not only can address the short-term issue of falling effective demand due to external factors, but also can improve productive capacity, enhance social stability and ensure environmental sustainability.

Endnotes

1 100 Indian rupee (rs) equates to $1.83 as of March 2013.

2 At stated, pensions are equivalent to the national poverty line. Moreover, the ratio of national poverty line to GDP per capita is assumed to remain unchanged in the forecast period, effectively implying that pensions grow at the same real rate annual as GDP per capita.

3 In the Russian Federation, coverage of the basic flat pension among all persons reaching the retirement age (60 for men, 55 for women) is virtually complete. As this pension of 3,170 Russian rubles ($103) per month is approximately equivalent to half of the national poverty line, the non-contributory pension scheme proposed here acts as a “top-up” to bring the basic pension to the national poverty lines.

4 This is particularly the case for some of the smaller economies in the region; Kiribati, New Zealand, Palau and, Solomon Islands spent more than 7% of their GDP on health in 2012. The Federated States of Micronesia, the Marshall Islands and Tuvalu spent more than 12% of their GDP.

5 Universal enrollment is considered to be achieved when rates reach 97%.

6 See unesdoc.unesco.org/images/0021/002183/218359e.pdf.

7 The United Nations Education, Scientific and Cultural Organization (UNESCO) launched the E-9 Initiative in 1993. Under this initiative, the nine most highly-populated developing countries (“countries of the South”, which comprise Bangladesh, Brazil, China, Egypt, India, Indonesia, Mexico, Nigeria and Pakistan, discuss their experiences in education, exchange best practices and monitor progress on achieving Education for All. These countries account for more than 60% of the world’s population and are home to more than two-thirds of the world’s illiterate adults and more than half of the world’s out-of-school children. See www.unesco.org/new/en/education/themes/leading-the-international-agenda/education-for-all/cooperation-mechanisms/e-9-initiative/.

8 See the final statement of the Global Education for All meeting document ED/EFA/2012/ME/1. Available from hunesdoc.unesco.org/images/0021/002183/218359e.pdf.

9 This is in line with a recent study that estimated the cost of implementing Millennium Development Goals targets in Asia and the Pacific and reported very large costs for LDCs in terms of percentage of GDP (ESCAP, 2010b).

10 Based on a cross-section of about 70 countries, the relationship is not quite linear as there are some low-income countries with high government expenditures, mostly financed by foreign aid, as well as some high-income countries with low government expenditures.

11 However, in this case the shares of revenues in GDP, several countries from the region, such as the Islamic Republic of Iran and the Russian Federation have exceeded the average for the countries with similar levels of GDP per capita. This may be due to resource rents that these countries are able to extract.

12 The simulations are based upon the Oxford Global Economic Model, which does not provide estimates for Fiji and Bangladesh. A more detailed discussion on the simulation approach and scenarios is presented in the appendix.

13 In the case of China, only the “small macro spillovers” scenario can be performed as the model will not converge in the long run if assumptions under the “Moderate Macro Spillovers” scenario are imposed. This is mainly because past growth for most macroeconomic variables in China has already been exceptionally high.

14 In addition to employment and worker earnings, the GDP deflator in the Oxford Economic Model is determined by non-labour production costs, such as global commodity prices, and the output gap. Thus, any temporary increases or decreases in the GDP deflator should not be interpreted as forecasts as the future path of the GDP deflator is driven by interactions of several macroeconomic variables. Changes in some of these variables are imposed as part of the analysis here.
ANNEX - METHODOLOGY

Employment for all

The required expenditure to provide an employment guarantee ($JG_i^t$ where superscripts refer to countries, subscripts to time) is estimated using the following equation:

$$JG_i^t = W_i^t \times IL_i^t \times T,$$

where $W_i^t$ is the expenditure required by country $i$ to employ a worker in year $t$. $IL_i^t$ represents the size of the informal sector in country $i$ at time $t$ and $T$ represents the length that the job guarantee is implemented each year. According to the example, a job guarantee is provided to each person informally employed for 100 days per year, hence $T = 100/365$.

As outlined above, the required expenditure of employing a worker is equivalent to the wage supplied by the job guarantee programme, including administration costs ($X_i^t$):

$$W_i^t = X_i^t + W_{2012}.$$

In each country the wage cost is equivalent to the national poverty line in 2012 ($NPL_{2012}^i$) relative to GDP per capita in local currency units in 2012 ($GDPPC_{2012}^i$). This ratio being kept constant in the forecast period 2013-2030. Moreover, in the above example, administration costs, ($X_i^t$), are assumed to be equivalent to 50% of the wage cost. Therefore,

$$W_i^t = 1.5 \times \frac{NPL_{2012}^i}{GDPPC_{2012}^i}.$$

The informal sector comprises all persons working in agriculture and all informal workers working in non-agriculture. Using $AG_i^t$ to represent the proportion of the labour force working in agriculture, $NA_i^t$ the proportion of the labour force working informally in non-agriculture, $Lab_i^t$ the working age population aged 15-64 and $Pop_i^t$ the total population results in:

$$IL_i^t = \frac{(AG_i^t + NA_i^t) \times Lab_i^t}{Pop_i^t}.$$

Data on the proportion of the labour force working in agriculture and working informally in non-agriculture are obtained from ILO statistics. Data pertaining to population are from the 2010 Revision of the World Population Prospects provided by the Population Division of the United Nations Department of Economic and Social Affairs. GDP per capita data are from the World Bank World Development Indicators database and data on national poverty lines are drawn from national sources.

As the expenditure of employing a worker is expressed in GDP per capita terms and the informal sector is expressed relative to the total population, the overall expenditure is expressed relative to GDP for each country.

Income security for the elderly

The expenditure required for a universal non-contributory pension ($NP_i^t$) to all aged 65 and older is calculated as follows:

$$NP_i^t = (X_i^t + B_i^t) \times Pen_i^t,$$

where $Pen_i^t$ denotes the proportion of persons aged 65 and older in each country across time and $B_i^t$ denotes the pension benefit. According to the assumptions, $B_i^t$ is equivalent to the national poverty line in 2012 relative to GDP per capita in local currency units in 2012. Thus,

$$B_i^t = \frac{NPL_{2012}^i}{GDPPC_{2012}^i}.$$

Administration costs are equivalent to 5% of total expenditure of the programme. As above, the pension benefit is expressed in GDP per capita terms and the number of beneficiaries is expressed relative to the total population. Therefore, the overall expenditure is expressed relative to GDP for each country.
Income security for persons with disabilities

Using data furnished in the *World Report on Disability* (WHO, 2011) and results of the *Global Burden of Disease: 2004 update* (WHO, 2008) by main regions, this report reports the average 15% of disability prevalence worldwide, (including mild and severe disability). With South-East Asia being the only ESCAP subregion for which data are available, its prevalence of severe disability is assumed to represent the disability situation of other countries in the ESCAP region. Moreover, people aged 60-64 years are assumed to have the same prevalence as the younger group (15-59 years), taking into account that the ‘all-ages’ prevalence is no different from the 15-59 year olds.

As the primary beneficiaries of any disability benefit schemes are the persons living with a severe disability, only the severe cases have been included in the estimation, differentiating between the proportion of women and men that are considered to be severely disabled (on average, about 3.1% and 2.7% of the relative genders, respectively, see table 4.2). Granting the disability benefit to those considered to be of working age, yet severely disabled yielded the relevant expenditure of such a programme across countries.

Health for all

The latest available data on the amount of public expenditure on health for a number of countries was from 2010. To achieve the target of spending 5% of GDP on public health, it is assumed that countries would increase their expenditure by the same percentage each year until 2030. The required percentage increase in public expenditure is calculated accordingly.

Education for all

In estimating the expenditure required to provide universal primary and secondary education, a simple linear upscaling of current expenditure, using current enrolment rates as an upscaling factor is used. Thus, the target public expenditure for universal enrolment at the relevant level of education (primary or secondary education) is calculated as follows:

\[
ED_{t}^{ij} = \frac{ED_{2011}^{ij} \times Enr_{t}^{ij}}{Enr_{2011}^{ij}}
\]

where \(ED_{t}^{ij}\) is the public expenditure (as a percentage of GDP) of country \(i\) on primary or secondary education \((j=1,2)\) in year \(t\), \(ED_{2011}^{ij}\) represents country \(i\)'s enrolment rate at level \(j\) and \(Enr_{t}^{ij}\) is the target enrolment rate. Specifically, universal enrolment is assumed to be achieved when 97% of the target population attends schooling, i.e. \(Enr_{2030}^{1,1} = Enr_{2030}^{1,2} = 0.97\).

As with health expenditure projections, the assumption is made that countries will increase their expenditure by the same percentage each year until 2030 and the required percentage increase in public expenditure is calculated accordingly.

Energy access for all

The expenditure estimation of the energy services is based upon indicators for electricity and cooking fuels and is based on the assumption that by 2030,
there will be 100% access to energy services in for country $i$.

Initially, the unit cost of energy supply is estimated by using the existing energy mix technologies (LPG, natural gas, biogass, grid, solar PV), costs related to distribution and transmission (per kWh) and capacity development cost (training programmes, materials/modules, resource person and experts).

$$\text{TC}_{2013}^i = (S_{2013}^i + U_{2013}^i) \times SE_{2013}^{2030} + CD_{2013}^i$$

where $\text{TC}_{2013}^i$ is the total expenditure for country $i$ and in year $t = 2013$, and the unit cost of energy is based on two components: $S_{2013}^i$ is the unit cost of energy supply and production through grid connections, as well as costs for distribution and transmission, and $U_{2013}^i$ is the end use cost from electricity and cooking. $E_{2013}^{2030}$ is the sustainable energy requirement for electricity and cooking fuel for households, which is supposed to be 100% access by year 2030. $CD_{2013}^i$ represents the capacity development expenditure for each of the years. The present value of the annual expenditure incurred during the project’s life is estimated with respect to year 2013 to 2030 (completion of the project) in terms of capital expenditure and recurrent expenditure.

These assumptions are used to calculate the annual investment required in countries to achieve 100% access to electricity and cooking fuels to total population in rural and urban areas, and are expressed as increase in their national public expenditure from 2013 for each year until 2030 and then expressed as a share in their GDP accordingly. The methodology for estimating the energy sector investment are largely based on the work of UNDP (2009b).

**Macroeconomic simulation**

The simulation exercise is based on the Oxford Global Economic Model, a globally linked macroeconomic model that is updated quarterly. The analysis covers eight emerging Asia-Pacific economies during 2013-2030, namely China, India, Indonesia, Malaysia, the Philippines, the Russian Federation, Thailand and Turkey. The simulation simultaneously imposes shocks to two sets of variables.

The first set of variables represents a policy shift towards inclusive and sustainable development through higher government consumption and public fixed investment. The composition of increased expenditure between these two components is country and year-specific, as guided by the costing analysis above. For example, a large proportion of the required fiscal expenditure in India is cash transfers on employment guarantees and elderly pensions, so up to 85% of additional spending is assumed to come from the government consumption side. In contrast, required spending on public health services and energy access in Indonesia is sizeable, so the share between government consumption and investment is more comparable.

The second set is macroeconomic variables that capture some of the channels on how the six selected areas of policy support measures on inclusive and sustainable development contribute to output growth, thus influencing the public debt-to-GDP ratio and inflation. These variables include the labour force participation rate, individual earnings, private domestic investment, merchandise imports, population growth and the total factor productivity trend. The choice of variables is largely shaped by data availability in the Oxford model. These six macroeconomic variables may not necessarily capture all linkages between inclusive and sustainable development and economic growth highlighted in the literature. For example, studies have shown that civic participation, governance, and political accountability improve in societies with more educated citizens. It is difficult to directly reflect these political developments in the Oxford model.

Two key assumptions are on the magnitude and timing of shocks. While the magnitude of the imposed changes on government consumption and investment is based on the previous exercise, determining the size of shocks for each macroeconomic variable is
less straightforward. For instance, while the potential employment and investment effect of an energy access programme has been studied, it is difficult to estimate the combined impact of all the six selected areas of inclusive and sustainable development. To do this for individual earnings and total factor productivity would be even more challenging.

The approach taken here is to view initiatives under the inclusive and sustainable development framework as a force that helps to upgrade a country’s potential growth. In most cases, the assumed magnitude of the shocks is relative to each variable’s own historical growth. For example, if it is assumed that individual earning growth in Indonesia would be 10% more rapid after pursuing inclusive and sustainable development, earning growth would rise from 12.3% recorded in the past decade to 13.5% during the simulation period. As such, the simulation results below should be viewed as an illustrative exercise. The focus should be on the long-run dynamics of public debt and price levels, rather a direct or narrow interpretation of the simulation outcomes on specific future levels of public debt and inflation.

**Simulation scenarios**

Up to three simulation scenarios are proposed, reflecting varying magnitude and timing of shocks on the macroeconomic variables. The first scenario, “small macro spillovers”, assumes that additional public spending helps to strengthen macroeconomic fundamentals beyond its direct impacts, such as fiscal injections on economic growth. Under this scenario, positive macroeconomic spillovers exist and persist throughout the entire simulation period. This implies reasonably good policy design and implementation.

More specifically,

- Benefiting from job guarantees, better health conditions and new employment opportunities in energy-related industries, the labour force participation rate during 2013-2020 is fixed at one percentage point higher than the baseline levels (the baseline numbers are taken from the Oxford Global Economic Model; the exception is population growth, where the baseline is from United Nations Population Division). This increases to 1.5 percentage points higher from 2021 onwards as the impact of greater access to basic education becomes more tangible in the labour force.

- Mean individual earnings growth during the period 2013-2022 is assumed to be 10% higher than its historical speed (2001-2011) due to, for instance, newly hired workers and longer work hours from improved health conditions. Since earnings are also used as a proxy for labour productivity, earnings growth is set to increase further at 20% higher than its historical pace from 2023 onwards as the benefits of universal access to education become more evident.

- Private domestic investment growth is initially assumed to increase only marginally in the first few years (same as the historical pace in 2013 and 5% more rapid in 2014) because positive spillovers from higher public investment will take time to take effect. After that, private investment accelerates on extending energy access, education, and health care services to more remote areas. Growth is set at 15% higher than its historical pace in the remaining years.

- Changes in merchandise imports are preliminarily driven by assumed changes in fuel imports. Fuel imports are set to be 5-10% higher than the baseline during the period 2013-2023 to reflect greater energy demand arising from a wider access. Fuel imports are set to decline afterwards with the emergence of renewable energy sector. A 20% reduction from the baseline is assumed. The final change in merchandise imports depends on the share of fuel imports in total imports.

- Total factor productivity is assumed to grow 10% more rapidly than the historical pace from 2013 onwards. Contributing factors include positive knowledge spillovers from a larger pool of educated citizens, enhanced production efficiency from new
ideas and technological catch-up, and stronger innovation effort in the energy-related industries.

- Population growth is set at 0.1 percentage point higher than the baseline during the period 2013-2022 due to reduced child mortality and higher adult survival rate. After that, the growth is fixed at 0.1 percentage point lower than the baseline as family size decrease, a trend generally observed in societies with rising educational attainment.

The second scenario, “moderate macro spillovers”, and the third scenario, “large macro spillovers” share similar concepts with the first scenario. The key difference is that the assumed magnitude of improvements in macroeconomic fundamentals is larger. For examples, under the small macro spillovers scenario, earnings growth is set to grow at 10-20% more rapid than the historical pace, while this is 20-40% under the moderate macro spillovers scenario and 70-150% under the large macro spillovers scenario. Table 4.3 compares the imposed changes on macroeconomic variables under the three simulation scenarios.

### Table 4.3. Assumed magnitude of changes in macroeconomic variables under different scenarios

<table>
<thead>
<tr>
<th>Macroeconomic variable</th>
<th>Unit</th>
<th>Scenario</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Small macro spillovers</td>
</tr>
<tr>
<td>Labour force participation</td>
<td>Percentage point higher than baseline</td>
<td>1.0 - 1.5</td>
</tr>
<tr>
<td>rate</td>
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</tr>
<tr>
<td>Individual earnings growth</td>
<td>Increase in growth rate relative to historical pace (%)</td>
<td>10 - 20</td>
</tr>
<tr>
<td>Private domestic investment</td>
<td>Increase in growth rate relative to historical pace (%)</td>
<td>0 - 15</td>
</tr>
<tr>
<td>Merchandise imports</td>
<td>Change in fuel import value relative to baseline (%)</td>
<td>-20 to +10</td>
</tr>
<tr>
<td>Total factor productivity</td>
<td>Increase in growth rate relative to historical pace (%)</td>
<td>0 - 10</td>
</tr>
<tr>
<td>trend</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Population growth</td>
<td>Percentage point change from baseline</td>
<td>-0.1 to +0.1</td>
</tr>
</tbody>
</table>

Source: ESCAP.
REFERENCES


REFERENCES


ECONOMIC AND SOCIAL SURVEY OF ASIA AND THE PACIFIC 2013


REFERENCES


REFERENCES


REFERENCES


The present Survey contains a new statistical annex which is shorter and focuses more on indicators for inclusive and sustainable development. The series included in the previous version of the statistical annex are available from www.unescap.org/pdd/publications/index_survey.asp. Readers are encouraged to give feedback about the new statistical annex by completing the readership survey available at the end of this publication.
<table>
<thead>
<tr>
<th>Region</th>
<th>Total 2011</th>
<th>Total 2011</th>
<th>Under 5 mortality rate</th>
<th>Life expectancy at birth (Years)</th>
<th>GDP (2005 US dollars) growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>East and North-East Asia</td>
<td>3 685</td>
<td>5 229</td>
<td>29.0</td>
<td>73</td>
<td>4.6 1.2</td>
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<tr>
<td>South-East Asia</td>
<td>3 685</td>
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<td>Africa</td>
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<td>2 711</td>
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<td>12.3 6.4</td>
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<tr>
<td>World</td>
<td>10 035</td>
<td>10 132</td>
<td>69.7</td>
<td>73</td>
<td>12.3 6.4</td>
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<tr>
<td>Latin America and the Caribbean</td>
<td>9 727</td>
<td>10 472</td>
<td>596.6</td>
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<td>East and North-East Asia</td>
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<td>12.3 6.4</td>
</tr>
</tbody>
</table>

Sources and notes appear in the technical notes at the end of the annex.
### Table 2. Poverty and inequality

<table>
<thead>
<tr>
<th>Region</th>
<th>Population living in poverty (PPP $1.25 a day)</th>
<th>Population living in poverty (PPP $2.00 a day)</th>
<th>Gini index</th>
<th>Mean log deviation index</th>
</tr>
</thead>
<tbody>
<tr>
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<tr>
<td>Developing economies</td>
<td>65.1 (90)</td>
<td>16.8 (09)</td>
<td>80.8 (90)</td>
<td>16.1 (09)</td>
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<td>East Asia</td>
<td>62.1 (90)</td>
<td>13.2 (09)</td>
<td>79.1 (90)</td>
<td>15.8 (09)</td>
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<td>South Asia</td>
<td>66.7 (90)</td>
<td>11.1 (08)</td>
<td>85.7 (90)</td>
<td>14.6 (08)</td>
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<tr>
<td><strong>Developed economies</strong></td>
<td>24.9 (90)</td>
<td>10.6 (07)</td>
<td>32.5 (90)</td>
<td>13.2 (07)</td>
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<tr>
<td>Developing South Asia</td>
<td>24.9 (90)</td>
<td>10.6 (07)</td>
<td>32.5 (90)</td>
<td>13.2 (07)</td>
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</tbody>
</table>

**Notes and sources**

1. The aggregates for the Gini index are calculated as the population-weighted averages of the Gini indexes of countries with two data points available. While the aggregates for the Gini index represent average within-country inequality for a group of countries, aggregates for the mean log deviation index represent total inequality, including both within-country and between-country inequality.

223
Table 3. Age dependency, education and employment

(Percentage)

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<td>Democratic People's Republic of Korea</td>
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<td>North and Central Asia</td>
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Sources and notes appear in the technical notes at the end of the annex.
Table 5. Access and connectivity

(Percentage)

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<th>Access to electricity</th>
<th>Affordability of mobile broadband</th>
<th>Fixed (wired)-broadband subscribers</th>
<th>Per 100 population</th>
<th>Millions of dollars of GDP</th>
<th>Tourist arrivals</th>
<th>Port container traffic</th>
<th>Paved roads</th>
<th>Percentage of the total length of the road network</th>
<th>Days to export</th>
<th>Cost to export US dollars per container</th>
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### East and North-East Asia

- **Developing economies**
  - China: 86, 68
  - Democratic People's Republic of Korea: 100, 98
  - Hong Kong, China: 88, 68
  - Macao, China: 88, 69
  - Mongolia: 90, 79
  - Republic of Korea: 88, 79

- **Developed economies**
  - Japan: 90, 79

### South-East Asia

- **Developing economies**
  - Brunei Darussalam: 90, 87
  - Cambodia: 88, 69
  - Indonesia: 91, 78
  - Lao People's Democratic Republic: 100, 98
  - Malaysia: 98, 79
  - Philippines: 98, 79
  - Singapore: 98, 79
  - Thailand: 98, 79
  - Timor-Leste: 98, 79
  - Viet Nam: 98, 79

- **Developed economies**
  - New Zealand: 98, 79

### South and South-West Asia

- **Developing economies**
  - Afghanistan: 90, 79
  - Bangladesh: 90, 79
  - Bhutan: 90, 79
  - India: 90, 79
  - Iran (Islamic Republic of): 90, 79
  - Maldives: 90, 79
  - Nepal: 90, 79
  - Pakistan: 90, 79
  - Sri Lanka: 90, 79
  - Turkey: 90, 79

### North and Central Asia

- **Developing economies**
  - Armenia: 90, 79
  - Azerbaijan: 90, 79
  - Georgia: 90, 79
  - Kazakhstan: 90, 79
  - Kyrgyzstan: 90, 79
  - Russian Federation: 90, 79
  - Tajikistan: 90, 79
  - Turkmenistan: 90, 79
  - Uzbekistan: 90, 79

- **Developed economies**
  - American Samoa: 90, 79
  - Cook Islands: 90, 79
  - Fiji: 90, 79
  - French Polynesia: 90, 79
  - Guam: 90, 79
  - Kiribati: 90, 79
  - Marshall Islands: 90, 79
  - Micronesia (Federated States of): 90, 79
  - Nauru: 90, 79
  - New Caledonia: 90, 79
  - Niue: 90, 79
  - North Mariana Islands: 90, 79
  - Palau: 90, 79
  - Papua New Guinea: 90, 79
  - Samoa: 90, 79
  - Solomon Islands: 90, 79
  - Tonga: 90, 79
  - Tuvalu: 90, 79
  - Vanuatu: 90, 79

- **Developed economies**
  - Australia: 90, 79
  - New Zealand: 90, 79

### Asia and the Pacific

- **Developing ESCAP economies**
  - Least Developed Countries: 90, 79
  - Landlocked Developing Countries: 90, 79

- **Developed ESCAP economies**
  - Australia: 90, 79
  - New Zealand: 90, 79

### Africa

- **Developed economies**
  - Africa: 90, 79

### Latin America and the Caribbean

- **Developed economies**
  - Latin America and the Caribbean: 90, 79

### North America

- **Developed economies**
  - North America: 90, 79

### World

- **Developed economies**
  - World: 90, 79
Technical notes

To ensure that aggregates are representative, they are calculated only if the population (for social indicators) or the GDP (for economic indicators) of countries with available values covers more than two thirds of the total population or GDP of the group of countries under consideration.

Table 1.

Gross domestic product per capita, current United States dollars

Gross domestic product in current United States dollars divided by the total population


Notes: Gross domestic product is the total market value of all final goods and services produced within the national borders in a given period of time. Individual country data are collected from national statistical offices of countries by the United Nations Statistics Division (UNSD) in the United Nations National Account Questionnaire (UN-NAQ); data on countries and years that are missing from UN-NAQ are estimated by UNSD. Aggregates are weighted averages using total population as weights. Data accessed in January 2013.

Gross domestic product per capita, valued at purchasing power parity

Gross domestic product in constant 2005 purchasing power parity (PPP) dollars divided by the total population

Sources: World Bank, World Development Indicators; United Nations Population Division, World Population Prospects, the 2010 Revision.

Notes: Gross domestic products are converted into PPP dollars using purchasing power parity rates of 2005. Aggregates are weighted averages using total population as weights. Data accessed on January 2013.

Population size, millions

Estimated mid-year population, covering all residents, regardless of legal status or citizenship, except for refugees not permanently settled in the country of asylum.


Notes: Estimated demographic trends are projections based on censuses, administrative data and surveys provided by countries through an annual questionnaire. Population data from all sources are evaluated by the United Nations for completeness, accuracy and consistency. Data accessed in May 2011.

Under 5 mortality rate, deaths per 1,000 live births

Probability that a child born in a specified year will die before reaching the age of five


Notes: Data are collected from countries by WHO / UNICEF from civil registration systems, population censuses and household surveys. Millennium Development Goal aggregation and imputation methods are used. Aggregates are weighted averages using the number of live births as weights. Data accessed in October 2012.

Life expectancy at birth, female/ male, number of years

The number of years a newborn female/male infant will live if prevailing age-specific mortality rates at the time of birth were to stay the same throughout the child's life


Notes: Aggregates are weighted averages using total population as weights. Data accessed in May 2011.

GDP growth, average annual percentage change

Average annual percentage growth rate of GDP at constant 2005 United States dollars.
Source: United Nations Statistical Division, National Accounts Main Aggregates Database

Notes: Aggregates are weighted averages using GDP in United States dollars at 2005 prices as weights. Data accessed in January 2013.

Table 2

Population living in poverty (PPP $1.25 a day), percentage of the population

Percentage of the population living on less than $1.25 a day at 2005 PPP prices

Source: United Nations, Millennium Development Goals Indicators Database

Notes: The indicator is produced by the World Bank Development Research Group based on microlevel data from nationally representative household surveys that are conducted by national statistical offices or by private agencies under the supervision of government or international agencies and obtained from government statistical offices and World Bank Group country departments. Global poverty indicators are adjusted for each country using an internationally comparable poverty line, enabling comparisons across countries to be made. Imputation and aggregation follow a methodology described in the statistical appendix of appendix of the Asia-Pacific Regional MDG Report 2011/12 (www.unescap.org/pdd/calendar/CSN-MDG-NewDelhi-Nov-2011/MDG-Report2011-12.pdf). Data accessed in July 2012.

Population living in poverty (PPP $2.00 a day), percentage of the population

Percentage of the population living on less than $2.00 a day at 2005 international prices

Source: World Bank, Development Research Group, World Development Indicators 2012

Notes: See Population living in poverty (PPP $1.25 a day). Data accessed in January 2013.

Gini index

Extent to which the income distribution within an economy deviates from a perfectly equal distribution

Source: World Bank, Development Research Group, World Development Indicators 2012

Notes: The Gini index ranges from 0 for perfect equality to 100 for absolute inequality. Data are based on primary household survey data obtained from government statistical agencies and World Bank country departments. Data on high-income economies are from the Luxembourg Income Study database. The aggregates for the Gini index are calculated as the population-weighted average of the Gini indexes of the countries with two data points available. They should be interpreted as representing average values of within-country inequality for specific subregions or regions. Data accessed in September 2012.

Mean log deviation index

Extent to which the income distribution within an economy deviates from a perfectly equal distribution


Notes: The mean log deviation (MLD) index, also known as the Theil's L index, varies between 0 and ∞ with zero representing an equal distribution and higher values representing higher levels of inequality. The MLD index differs from the Gini index in that it can be aggregated across subgroups, in this case across countries. The value of the MLD index for a group of countries represents the total inequality for that group of countries, including both within-country inequality and between-country inequality. Data are based on primary household survey data obtained from government statistical agencies and World Bank country departments. The aggregates for the MLD index are calculated for countries that have two data points available. Data accessed in November 2012.

Table 3

Child dependency ratio, percentage

The ratio of the population of age 0 to 14 to the population aged 15 to 64


Notes: Aggregates are weighted averages using the population aged 15 to 64 as weights. Data accessed in May 2011.

Old age dependency ratio, percentage

The ratio of the population aged 65 and above to the population aged 15 to 64


Notes: Aggregates are weighted averages using the population aged 15 to 64 as weights. Data accessed in May 2011.

Average years of schooling of adults (aged 15 and above), total/female

Average number of years of education received by people aged 15 and above

Notes: Figures are calculated from survey data on education attainment levels using official durations of each level. Aggregates are weighted averages using the population aged 15 and above as weights. Data accessed in January 2013.

Adult literacy rate, percentage of population aged 15 and above

The percentage of people aged 15 years and above who can read with comprehension and write a short, simple statement about their everyday life.


Notes: Generally, literacy also encompasses numeracy or the ability to make simple arithmetic calculations. Values mainly obtained from population censuses and household and/or labour force surveys. UNESCO, Institute for Statistics collects education statistics in aggregate form from official administrative sources at the national level. Collected information encompasses data on educational programmes, access, participation, progression, completion, internal efficiency and human and financial resources. Data accessed in October 2012.

Employment-to-population ratio, female/male, percentage of females/males aged 15 and above

The proportion of the working-age female/male population that is employed.

Source: International Labour Organization (ILO), Key Indicators of the Labour Market, Seventh Edition

Notes: For most countries, the working-age population is defined as persons aged 15 and above, although that may vary slightly from country to country. The ILO Employment Trends unit has designed and maintains three econometric models that are used in estimating labour market indicators of the countries and years for which no real data exist, disaggregated by sex and age. Information was derived from a variety of sources, including household or labour force surveys, official estimates and censuses provided by countries to ILO. In a very few cases, information was derived from insurance records and establishment surveys. Aggregates are calculated by the ILO Employment Trend Unit. Data accessed in July 2012.

Vulnerable employment, percentage of total employment

The sum of contributing family workers and own-account workers as a percentage of total employment.

Source: International Labour Organization, Key Indicators of the Labour Market, Seventh Edition

Notes: Data accessed in January 2013.

Table 4

Domestic material consumption, kg per United States dollar of the year 2000

Total amount of materials used by an economy, defined as the annual quantity of raw materials extracted from the domestic territory plus all physical imports minus all physical exports, divided by the GDP at constant 2000 United States dollars.


Notes: Aggregates are weighted averages using GDP in United States dollars of the year 2000 as weights. Data accessed in February 2013.

Domestic material consumption, tonnes per capita

Total amount of materials used by an economy in a given year divided by the total population.

Source: Commonwealth Scientific and Industrial Research Organisation and United Nations Environmental Programme, Asia-Pacific Material Flows online database; United Nations Population Division, World Population Prospects, the 2010 Revision

Notes: Aggregates are weighted averages using the total population as weights. Data accessed in February 2013.

Total primary energy supply per capita, tonnes of oil equivalent (toe) per capita

Sum of the energy demand used for power generation, other energy sectors, industry, transport, residential and commercial buildings, agriculture and other sectors divided by the total population.


Notes: Total primary energy supply (TPES) per capita is equivalent to total primary energy demand per capita. Countries report to IEA through the Organisation for Economic Cooperation and Development (OECD) member site and the non-OECD government site. Aggregates are weighted averages using the total population as weights. Data accessed in January 2013.

Indigenous energy production per capita, tonnes of oil equivalent (toe) per capita

Total quantity of fuels extracted or produced, calculated after
any operation for removal of inert matter, divided by the total population
Source: IEA, World Energy Balances database; United Nations Population Division, World Population Prospects, the 2010 Revision

Notes: Indigenous production is the production of primary energy, such as hard coal, lignite, peat, crude oil, natural gas liquids, natural gas, combustible renewables and waste, nuclear, hydro, geothermal, solar and the heat from heat pumps that is extracted from the ambient environment. Aggregates are weighted averages using the total population as weights. Data accessed in January 2013.

Total freshwater withdrawal per capita, m³ per capita per annum
The gross amount of water extracted, either permanently or temporarily, from surface water or groundwater sources minus that produced from non-conventional water sources, such as reused treated wastewater and desalinated water, divided by the total population
Source: Food and Agriculture Organization of the United Nations, AQUASTAT; United Nations Population Division, World Population Prospects, the 2010 Revision
Notes: Aggregates are weighted averages using the total population as weights. Data accessed in February 2013.

Carbon dioxide (CO₂) emissions, tonnes per capita
CO₂ emissions divided by the total population. CO₂ emissions per capita figures are based on population figures (WPP, 2010). Estimates of total CO₂ emissions include anthropogenic emissions, less removal by sinks, of CO₂. The term “total” implies that emissions from all national activities are considered. The typical sectors for which CO₂ emissions/removals are estimated are energy, industrial processes, agriculture, waste, and the land use, land-use change and forestry (LULUCF).
Source: MDG Indicators Database. The Carbon Dioxide Information Analysis Center (CDIAC) estimates carbon dioxide emissions from fossil-fuel consumption and land-use changes; records of atmospheric concentrations of CO₂ and other radiatively active trace gases; carbon cycle and terrestrial carbon management datasets and analyses; and global/regional climate data and time series.
Notes: Aggregates are weighted averages using the total population as weights. Data accessed in February 2013.

Table 5

Access to improved water sources, percentage of the population
Proportion of the population with access to improved water sources
Source: United Nations, Millennium Development Goals Indicators Database
Notes: Improved water sources include household water connection, public standpipe, borehole, protected dug well, protected spring, rainwater collection and bottled water (if the secondary available source is also improved). Imputation and aggregation follow a methodology described in the Asia-Pacific MDG Report 2011 (www.unescap.org/stat/statpub/mdg-progress-classification/TN-01-progress-classification.pdf). Countries report data to the WHO /UNICEF Joint Monitoring Programme (JMP) for Water Supply and Sanitation. The primary data sources used in international monitoring include nationally representative household surveys, including multiple indicator cluster surveys (MICS), demographic health survey (DHS), the World Health Survey (WHS), Living Standards and Measurement Survey (LSMS), the Core Welfare Indicator Questionnaire (CWIQ), Pan Arab Project for Family Health surveys (PAPFAM) and population censuses. Such data are entered into the JMP database after validation with objective criteria. Data accessed in July 2012.

Access to improved sanitation, percentage of the population
Proportion of the population with access to improved sanitation
Source: United Nations, Millennium Development Goals Indicators Database
Notes: Improved sanitation refers to facilities which include flush or pour-flush toilet or latrine to: piped sewerage; a septic tank or pit; a ventilated improved pit (VIP) latrine; a pit latrine with slab; or a composting toilet or latrine. Imputation and aggregation follow a methodology described in the Asia-Pacific MDG Report 2011 (www.unescap.org/stat/statpub/mdg-progress-classification/TN-01-progress-classification.pdf). See above for details on country reporting. Data accessed in July 2012.

Access to electricity, percentage of the population
Proportion of the population with access to electricity
Source: IEA, World Energy Outlook 2011
Notes: Electrification data are collected from industry, national surveys and international sources. If electricity access data for 2009 was not available, data for the latest available year was used. The number of people without electricity access as well as the urban/rural breakdown was assessed with input from the World Population Prospects, the 2010 Revision. Additionally, United Nations data has been adjusted with data from the IEA Statistics Division in order to get the most accurate demographic estimate for 2009 - electricity access data was adjusted to be consistent with demographic patterns of urban/rural population. Due to differences in definitions and methodology from different sources, data quality may vary from country to country. In cases in which country data appeared contradictory, outdated or unreliable, the IEA Secretariat made
estimates based on cross-country comparisons and earlier surveys. Aggregates are weighted averages using the total population as weights. Data accessed in February 2013.

### Affordability of mobile broadband, price as percentage of GNI per capita

Cost of prepaid, handset-based mobile-broadband services divided by the Gross National Income per capita in 2011


**Notes:** The cost of mobile-broadband services is the cost of a monthly subscription to an entry-level fixed-broadband plan based on a monthly data usage of 1 GB at a minimum speed of 256 kbit/s. In cases in which several offers are available, preference is given to the cheapest available connection that offers a speed of at least 256 kbit/s and 1 GB of data volume. If providers set a limit of less than 1 GB on the amount of data that can be transferred within a month, then the price per additional byte is added to the monthly price so as to calculate the cost of 1 GB of data per month. Installation charges, modem prices or telephone-line rentals are not included. Aggregates are weighted averages using the total population as weights. Data accessed in January 2013.

### Fixed (wired)-broadband subscribers, per 100 population

Subscriptions to high-speed access to the public Internet at downstream speeds equal to or greater than 256 kbit/s divided by the total population and multiplied by 100

**Source:** International Telecommunication Union, World Telecommunication/ICT Indicators Database

**Notes:** Subscriptions include those based on cable modem, DSL, fibre-to-the-home /building and other and exclude those based on access to data communications including the Internet via mobile-cellular networks. Aggregates are weighted averages using the total population as weights. Data accessed in January 2013.

### International tourist arrivals, millions

Number of visitors from other countries staying in the country at least for one night.

**Source:** United Nations World Trade Organization (UNWTO).

**Notes:** Data accessed in September 2012.

### Days to export

The time necessary to comply with all procedures required to export goods in 2012

**Source:** World Bank, *Doing Business Report*

**Notes:** If a procedure can be accelerated for an additional cost, the fastest legal procedure is chosen. Aggregates are weighted averages using the total population as weights. Date accessed in January 2013.

### Cost to export, United States dollars per container

The cost associated with all procedures required to export goods in 2012

**Source:** World Bank, *Doing Business Report*

**Notes:** The cost includes the costs for documents, administrative fees for customs clearance and technical controls, customs broker fees, terminal handling charges and inland transport. Aggregates are weighted averages using the total population as weights. Date accessed in January 2013.
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Half a decade since the onset of the Great Recession, the Asia-Pacific region continues to anchor the global economy, but its rate of economic growth remains subdued compared to the pre-global financial crisis period. It is also showing signs of strain, as uncertainty and crisis deepen in the United States and the euro zone. More importantly, the Asia-Pacific region’s growth path continues to leave behind hundreds of millions and to put unsustainable pressure on the natural resource base.

The 2013 edition of the Economic and Social Survey of Asia and the Pacific argues that macroeconomic policies can play a key role not only in supporting the economies of the region in the short term, but also in reorienting the region towards a more inclusive and sustainable pattern of development. By carefully designing short-term support measures, it is possible to sustain growth as well as address long-term structural issues.

As an illustrative example, the Survey 2013 estimates, for a number of Asia-Pacific countries, the public investment needs required to deliver a package of policies to sustain growth and to promote inclusive and sustainable development. The policy package comprises a job guarantee programme, a universal pension scheme, disability benefits, increased public health spending, universal school enrolment and universal access to modern energy.

The Survey finds that most countries can finance such a package without jeopardizing macroeconomic stability, although least developed countries would also require global partnership and development cooperation. The analysis underlines the need to move forward the regional development agenda from a discussion on the future we want to the means of implementation to realize that future.

"At the [...] Rio+20 United Nations Conference on Sustainable Development in 2012, world leaders pledged to adopt forward-looking macroeconomic policies that promote sustainable development and lead to sustained, inclusive and equitable economic growth [...] The Economic and Social Survey of Asia and the Pacific 2013 makes it clear that such investments are not only essential but also affordable."

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