ECONOMIC AND SOCIAL SURVEY OF ASIA AND THE PACIFIC 2015

MAKING GROWTH MORE INCLUSIVE FOR SUSTAINABLE DEVELOPMENT

UNITED NATIONS
ESCAP
Economic and Social Commission for Asia and the Pacific

ECONOMIC AND SOCIAL SURVEY OF ASIA AND THE PACIFIC 2015

MAKING GROWTH MORE INCLUSIVE FOR SUSTAINABLE DEVELOPMENT

United Nations publication
Sales No. E.15.II.F.7

Printed in Bangkok
ISBN: 978-92-1-120690-6
e-ISBN: 978-92-1-057374-0
ISSN: 0252-5704
ST/ESCAP/2714

FOREWORD

The 2015 edition of ESCAP's *Economic and Social Survey of Asia and the Pacific* covers an issue that is of special international importance this year: inclusive growth. This issue has direct bearing on the three global priorities for 2015: completing the Millennium Development Goals; adopting an ambitious new sustainable development agenda, including a set of sustainable development goals (SDGs); and reaching a meaningful, universal agreement on climate change.

The developing economies of the Asia-Pacific region continue to lead the global economic recovery. However, the economic expansion remains lower than pre-crisis levels and is not commensurate with growing populations and incomes of the region. Despite success in reducing poverty, the *Survey* shows an increase in income inequality. There are also inequalities in terms of opportunities between the richest and the poorest, between urban and rural areas, and between regions within the same country.

The *Survey* also demonstrates that while access to health, education, clean drinking water and other basic public services improved between the 1990s and the 2000s, the opportunity for every citizen to benefit from them actually shrank due to such factors such as gender and the level of income of one's parents.

This growing inequality can be partially explained by the unequal distribution of capital, and the *Survey* contains useful proposals to improve the pattern of public expenditures and increase access to financial services.

This analysis is especially timely as negotiations on the post-2015 development agenda and regional consultations on financing for development move into high gear. These two processes will culminate in an agreement to rethink strategies to mobilize financing for development in Addis Ababa in July ahead of the adoption of a universal and transformative post-2015 development agenda, including a set of sustainable development goals, in New York in September. It can also contribute to the negotiations that will culminate at the Conference of the Parties to the United Nations Conference on Climate Change, to be held in Paris in December.

I commend ESCAP for its insightful analysis, practical advice and recommendations for policymakers in Asia and the Pacific and beyond. These proposals should be factored into global efforts to build the more inclusive, resilient and sustainable future we want.

Ki Moon Ban

April 2015

BAN Ki-moon
Secretary-General of the United Nations

PREFACE

As we transition globally from the Millennium Development Goals (MDGs) to a more ambitious path of sustainable growth and development, inclusiveness must be integrated and mainstreamed in policy-making. There is ample evidence that economic growth is necessary, but definitely not sufficient for shared and sustainable prosperity. Asia and the Pacific is no exception, even as the region continues to lead global growth. ESCAP's *Economic and Social Survey of Asia and the Pacific 2015* underscores the need for the adoption of policies necessary for inclusive growth, which is both a prerequisite for meeting the outstanding MDG commitments and critical for effective implementation of an ambitious sustainable development agenda in the post-2015 era.

Taking a multidimensional approach, and tracking 15 indicators of inclusiveness, the *Survey* for 2015 assesses the extent to which the Asia-Pacific region's rapid economic growth over the past two decades has improved welfare for different groups. The region stands out for its accomplishments in achieving high growth and leading progress on the MDGs since the 1990s. However, two major trends remain worrisome: (i) several countries lag behind in their economic and social transformation; and (ii) significant disparities remain across gender, urban-rural sectors, and income quintiles. Particularly worrying is the fact that multiple forms of deprivation tend to reinforce each other. For instance, high income inequality worsens the distribution of opportunities in gaining access to quality education, adequate healthcare services, improved sanitation, clean drinking water and reliable energy. Similarly, deteriorating environmental conditions make it more difficult for socioeconomic progress to be sustained.

Renewed emphasis on how "inclusiveness" works, and which policies will achieve a deeper and lasting impact on human welfare, is warranted. The Asia-Pacific growth trajectory, while encouraging in some areas, lags behind in others, and is in a process of adjustment in major economies of the region. Augmenting and enhancing inclusiveness will only be achieved if accompanied by a multidimensional strategy that recognizes the need for simultaneous advances in the economic, social and environmental aspects of development. When such advances are backed by good policies, supportive legal and regulatory frameworks and effective political governance, the likelihood of success increases even further.

ESCAP's 71st session is squarely focused on balancing and integrating the three core elements of sustainable development. Our work emphasizes that inclusive growth reinforces sustainable development in all areas, and that exploiting synergies across these elements is critical. To achieve better sustainable development outcomes, it will also be critical for governments to launch integrated and well-designed packages of inclusive policies, auguring well for decent employment, job security, adequate access to basic services such as health, education and water, as well as the imperative to stay within critical environmental boundaries.

Among others, the *Survey* for 2015 identifies small and medium enterprises and the agricultural sector as high-priority areas, given their high employment-intensity and potential for productivity gains from policy interventions such as fiscal and labour market policies, together with the importance of financial inclusion and infrastructure investment.

Change is, however, warranted across the board. The latest macroeconomic outlook for the Asia-Pacific region points to only a slight pick-up in economic growth and to a deceleration in the rate of expansion. Also, there will be a noticeable decline in inflation during 2015 in developing economies of the region.

Declining growth in oil-dependent economies, subdued global trade and likely volatility in capital flows are all expected to pose challenges to the sustainability of economic growth. Commodity-dependent economies may face further difficulties from negative terms of trade shocks.

Beyond these immediate challenges, longer-term barriers to inclusive growth include structural barriers to women’s participation in both the economy and wider society, persistently high levels of vulnerable employment, infrastructure shortages, as well as environmental and climate-related challenges. Addressing these challenges will position the region well to adopt a more sustainable development path.

However, this will require strong macroeconomic management, with the right mix of macroprudential policies to support monetary policies in managing large capital flows; mobilization of resources through public and private channels to boost infrastructure investment; policies to address pro-cyclicality and promote diversification in commodity-dependent economies; as well as climate change adaptation and mitigation measures.

Any effective analysis of the Asia-Pacific region must consider the enormous diversity and different levels of development across countries and subregions. The macroeconomic outlook and policy challenges differ at the disaggregated level, and call for policies to be redesigned to better align with subregional and country circumstances. Examples of these include: the spill over impact of the Russian Federation’s slowdown on North and Central Asian economies; the employment- and climate-related challenges in Pacific island developing economies; and the macroeconomic imbalances coupled with severe power shortages in South and South-West Asia. The impact of China’s rebalancing for East and North-East Asia; as well as ways to control credit-driven consumption and boost investment in infrastructure and skills in South-East Asia, are some of the other critical areas of concern.

2015 is a year of global action, when the international community is expected to adopt a universal and transformative post-2015 development agenda and a meaningful agreement on climate change action. Other major events include landmark international conferences on disaster risk reduction and on financing for development. Countries in the Asia-Pacific region are already actively engaged in these global processes, while introducing reform policies at home. Moreover, ESCAP member States are working together on multiple fronts of regional cooperation, such as trade, connectivity, finance and natural disasters resilience and risk reduction. Several exciting developments are unfolding, including the establishment of the ASEAN Economic Community, the Asian Infrastructure Investment Bank and the New Development Bank. As the most comprehensive regional platform in Asia and the Pacific, ESCAP will continue to work closely with all regional bodies and stakeholders to achieve these aims.

I sincerely hope that the *Survey* for 2015 will benefit its readers and contribute to the broader global, regional, and national deliberations to render growth more inclusive, resilient and sustainable.

Shamshad Akhtar
Under-Secretary-General of the United Nations and
Executive Secretary, United Nations Economic and
Social Commission for Asia and the Pacific

EXECUTIVE SUMMARY

The year 2015 marks a watershed in global policymaking. Building on the Millennium Development Goals (MDGs), the world is set to adopt sustainable development goals in 2015. Subsuming unattended MDGs, the success of the sustainable development goals will depend on how effectively the Asia-Pacific region makes economic growth more inclusive. The *Economic and Social Survey of Asia and the Pacific 2015* analyzes the economic growth performance of the region, along with its outlook and challenges countries face in sharing the benefits of growth with all people.

The region stands out for its economic growth achievements, albeit in a somewhat uneven manner. Real incomes per capita in developing economies of the region have doubled on average since the early 1990s. Particularly impressive is a seven fold increase in real income per capita in China since 1990, as well as its tripling in Bhutan, Cambodia and Viet Nam over the same period. Besides other policies, this economic growth performance has helped lift millions of people out of extreme poverty– ahead of the 2015 MDG deadline– and reduced by half the proportion of people whose income is less than $1 a day.

With expectation of only a slight increase in the region's economic growth rate in 2015 and 2016, the region has to be more vigilant in ensuring that it does not lose sight of the goal of reducing extreme poverty as well as working towards ensuring that the gains of prosperity are evenly shared. This is critically important as even during the high growth period there was pervasive, sharp and growing inequality of incomes and opportunities. Rural-urban and geographical gaps in socioeconomic development also remain and inequalities among women and men are enhancing the vulnerabilities of those on the margins of society.

The *Survey* for 2015 advocates continued policy focus on economic growth but underscores that there has to be recognition that while growth is necessary, it is definitely not sufficient for achieving "development". Preparing the region to adopt and adapt the sustainable development goals calls for nurturing better understanding of the dynamics of inclusive growth –what it stands for, how governments need to internalize its elements into domestic policy frameworks, and how it can be reinforced by focusing on sustainable development.

The first chapter of the *Survey* for 2015 offers perspectives on Asia-Pacific's macroeconomic outlook and performance and outlines the key economic challenges facing the region together with key policy options available to policymakers. To reflect the diversity of the Asia-Pacific region, the second chapter analyzes the recent developments in five subregional groups and their issues and challenges, which offers an opportunity to share experiences and policy considerations. Finally, the third chapter focuses on analyzing the trends and policies adopted in the region on promoting inclusive growth, with the objective of distilling key recommendations drawn from lessons learnt.

Economic growth outlook and policy challenges

Economic growth in Asia and the Pacific continues to fare well in the global context, but is expected to increase only slightly to 5.9% in 2015 from 5.8% in 2014. This slowdown in the rate of expansion of economic growth is happening at a time when lower oil prices could potentially have lifted growth in oil importing countries if the enabling environment was right. Unless reforms are vigorously pursued, downside risks to the growth trajectory could increase.

Since the region's economic growth outlook is primarily influenced by domestic and intraregional factors, rather than external factors, countries have the opportunity to change the growth dynamics. The role of private consumption and investment in the region is expected to be much more pronounced in driving economic growth than exports, the prospects for which remain less upbeat. Generally, the economic growth of the region's developing economies is below potential and below pre-crisis level as a range of structural weaknesses remain, such as infrastructure shortages, the excessive commodity-dependence of some economies and low productivity. The fragile global economic recovery continues to be an additional drag for the region's growth prospects.

Since demand continues to increase due to growing populations and incomes, it is critical to enhance the supply potential of developing economies by focused efforts on improving the availability and quality of infrastructure. Urbanization throughout the region is, in any case, generating additional demands for infrastructure. Growing demand for infrastructure development calls for not only exploiting further the traditional sources of finance, such as tax receipts and overseas development assistance, but looking at tapping broader sources of financing, such as regional capital markets by ensuring development of local currency bond markets, and encouraging public-private partnerships to leverage financing and skills. A supportive legal and regulatory environment together with enhanced capacity to evaluate infrastructure projects can go a long way in achieving this objective. The emergence of new development banks, such as the Asian Infrastructure Investment Bank, will also be able to contribute to the infrastructure development in the region.

A combination of somewhat reduced economic activity and lower international oil prices has improved the inflation outlook, which is expected to decelerate to 3.3% in 2015 from 3.9% in 2014. The dramatic decline in international oil prices has allowed space for reforms of fuel subsidies which, with proper fiscal management, can be deployed to support infrastructure investment and inclusive growth measures. Both these considerations require some lead time to structure interventions and thus there is no major positive impact of declining oil prices on growth yet. Savings from fuel subsidies should not distract attention from tax policy reforms which is the only sustainable approach to strengthening public finances critical for macroeconomic stability and for generating adequate resources for development spending.

Lower inflation has allowed room for monetary accommodation. This is evident from a string of interest rate reductions in many regional economies. Liquidity thus generated, if effectively intemediated, could stimulate economic momentum. Reductions in interest rates by Asia-Pacific central banks are happening at a time when the United States is entering into a monetary tightening mode. However, the United States is still watching its own economic dynamics before proceeding with more determined action. The continued monetary easing by Japan and the eurozone, on the other hand, is keeping the benchmark rates low for their respective economies. Within the Asia-Pacific region, particularly in emerging markets, there remain concerns regarding the volatility in capital flows and exchange rates triggered by the global monetary stance. A comforting factor this time round is improvement in current account balances of oil importing countries due to declining oil prices, though recovery in exports is lagging despite appreciation of the dollar. However, risks of asset price volatilty, driven by investor sentiments to United States monetary tightening, remain and could complicate macroeconomic and financial stability in the region.

Developing economies in the region have strengthened their capacities to implement macroprudential policies, such as caps on loan-to-value ratios, limits on certain segments of credit growth and capital and reserve requirements, which offer approaches to manage the implications of capital flow volatility. Unlike interest rate adjustments and interventions in the foreign exchange market, the macroprudential measures directly target the source of instability of capital flow volatility, namely the domestic asset markets in which capital flows are invested, and thus help in containing market disruptions. However, countries with weak fundamentals will have greater difficulty in mitigating risks.

So far, currencies in the Asia-Pacific region have generally depreciated less than the global trade-weighted average. This is because either the Governments are intervening in the foreign exchange markets and/or there remains a continuing institutional investor interest in developing economies in search of high yields.

Against this backdrop of declining commodity prices, evolving global and regional monetary policy developments and volatility in financial markets, it is worth highlighting that policymakers must not underestimate the risks associated with complex and deep financial market inter-linkages with the rest of the economy. Among many lessons that can be drawn from the experiences of the recent global financial and economic crisis, this is perhaps the most important. Therefore, the monetary policy stance in the region will need to be calibrated much more cautiously in going forward.

Many economies in the region excessively depend on certain commodities for fiscal revenues and foreign inflows. The vulnerability of such economies increases considerably in an environment of declining commodity prices. Increased financialization of commodities further exacerbates the difficulties. Among other structural measures, policymakers in these economies could consider fiscal rules that factor in the dynamics of business cycles and target a “cyclically adjusted fiscal balance” to better plan for contingent risks associated with the potential revenue shocks stemming from large movements in commodity prices. Also, a consumer price index-based inflation target may not be appropriate for countries susceptible to terms-of-trade shocks. A production-oriented index could serve as a better indicator and be used as a nominal anchor for inflation expectations.

Perspectives from subregions

The Asia-Pacific region, given its wide diversity, does face some unique and some common trends and challenges.

The relatively high income bloc of East and North-East Asia has to cope with the slowing demand from China and other intraregional trade hubs. China, accounting for around 40% of output of this subregion, has witnessed a moderate growth in investment as the economy shifts towards more consumption-led growth. Japan’s household spending also dipped following an increase in the consumption tax. Stimulating intraregional trade calls for enhancing trade connectivity and lowering barriers to trade. The region is grappling with policies to boost domestic demand but their success would be constrained by the current high debt levels and rapidly ageing populations in some key economies of the subregion.

Unlike other subregions, North and Central Asia is facing low economic growth but high inflation. Weighed down by lower global oil prices and geopolitical tensions, the economy of the Russian Federation barely grew in 2014; it is expected to contract over 2015 and 2016. As the country accounts for 80% of the output in North and Central Asia, subregional growth performance and prospects are also bleak. Inflation has also increased in several economies as declining commodity prices led to subdued foreign exchange earnings and the weakening of currencies. The subregion needs to initiate concerted policy reforms to diversify and reduce reliance on natural resources or workers’ remittances for economic growth. This would involve creating a dynamic, entrepreneurial private sector and strengthening the linkages between resource and non-resource-based sectors.

The Pacific island developing economies are set to experience faster growth due to strong energy exports in Papua New Guinea, post-cyclone reconstruction activity in some countries and expected increases in tourism and remittance receipts. However, economic performance in the subregion remains highly vulnerable to frequent natural disasters. To better cope with associated economic challenges, the subregion needs a more vibrant business sector, which would expand the economic base, reduce youth unemployment and support government revenue that could be spent on boosting service delivery in rural areas and outer islands. Enhancing infrastructure networks and human and institutional capacity are also critical to overcome medium-term challenges.

Economic growth in South and South-West Asia edged up in 2014, mainly led by stronger macroeconomic performance in India, but it remained far below its pre-crisis pace. The consumption-led growth was fuelled by favourable farm incomes, workers’ remittances and monetary easing. The near-term outlook is optimistic, but conditional on continued domestic reform efforts in large economies, which would unleash the subregion’s high potential for growth. Limited intraregional trade within this subregion, however, could limit the positive spillovers into relatively smaller economies. Moreover, given the sizeable macroeconomic imbalances in many subregional economies, a key reform area has to be the broadening of the tax base and the stemming of tax evasion. These steps would lower public borrowings that have added inflationary pressure and constrained financing to the private sector. Larger fiscal space due to tax reforms would also help address severe power shortages, which are the key growth constraint for the subregion. An appropriate framework for public-private partnerships and enhanced corporate governance in public enterprises are also needed to tackle the persistent energy crisis.

Economic growth slowed in South-East Asia in 2014 primarily due to monetary tightening and weak commodity exports in Indonesia and political unrest in Thailand. Although the near-term outlook is projected to improve, exacerbating medium-term growth constraints are shortages of public infrastructure and skilled labour. The subregion needs to effectively mobilize part of its available savings to reverse the declining trend in outlays on public infrastructure, and enhance the quality of education and vocational training to match the needs of job markets.

Inclusive growth in Asia and the Pacific

Understanding the economic growth dynamics and prospects of the Asia-Pacific region together with recognizing its achievements in terms of higher growth and poverty reduction remain an important endeavor. However, development and overall human welfare is a multidimensional concept that is about more than just increasing the levels of income and reducing the levels of poverty. As highlighted in the first *Human Development Report:* “The purpose of development is to offer people more options. One of their options is access to income [….] But there are other options as well, including long life, knowledge, political freedom, personal security, community participation and guaranteed human rights”.

Inclusiveness of economic growth is a multidimensional concept. Yet, while the term “inclusive growth” has been widely used by Governments, international organizations and other stakeholders in recent years, there is still a lack of consensus on its concept and dimensions. Keeping in view the broad social objective of human well-being, *inclusiveness* as defined below encompasses the dimensions of *economic inclusiveness, social inclusiveness* and *environmental inclusiveness.*

To enhance inclusiveness there is need to focus on and analyse people’s wellbeing – the ultimate objective of any society – by focusing on: (a) increasing the average standard of living of the population (captured by average real income per capita); (b) reducing income inequality; (c) reducing levels of extreme poverty; and (d) expanding and broadening equality in opportunities, such as access to public goods.

Trends and patterns of inclusive growth in the region

Identifying and analysing underlying trends and patterns of inclusiveness within each of the three dimensions of development enables an assessment to be made on how inclusive overall growth has been within each of these dimensions. In the *economic* dimension, for instance, trends in GDP growth, poverty, income inequality and employment show that, while rates of extreme poverty have declined by half or more in most economies in the region due to higher GDP growth, poverty measured at the $2 line is still very high. Moreover, there are large divergences in poverty rates within countries, usually across gender, but also between rural and urban areas, with extreme poverty in rural areas usually being higher than in urban areas. At the same time, it is noticeable that increases in the levels of real income have not always been distributed evenly within countries. On the contrary, income inequality has increased in many countries in the region, especially in the major developing countries, particularly in urban areas. Thus, since the 1990s, the population-weighted mean Gini index, a measure of income inequality, for the entire region rose from 33.5 to 37.5.

Another important factor of *economic* inclusiveness includes the availability of productive and decent employment as this is a decisive factor in lifting the poor out of poverty and reducing income inequalities. In most developing countries economic growth has not necessarily resulted in commensurate employment growth given sector concentration and lack of labor demand in the productive sector. Agriculture, the sector contributing to livelihood for large proportions of the population, is shrinking and delivers low yields. The growing significance in the region of the services sector and industry, while partly compressing the contribution of agriculture to the region's GDP, has had a positive effect on diversification but needs to be accompanied by job generation. Addressing the neglect of the rural sector is thus crucial in order to reduce poverty and inequality.

To assess and promote inclusiveness in the *social* dimension, countries need to go beyond "inequality in income" and promote "equality of opportunity" through broadening access to quality education and adequate health-care services. Differences in access to education across the sexes, across income quintiles and across rural and urban sectors, have impacted opportunities for empowerment and economic productivity. Gender gaps are often more pronounced in rural areas, girls usually receive less education, particularly in lower-income quintiles, and gaps in education between boys and girls are primarily an issue of income. This situation also holds true for the quality of education, with the poor attending mainly inadequately maintained overcrowded public schools, which can over time aggravate intergenerational inequality.

To reduce prevailing disparities in distribution, improvement in the health status of the poor is critical and helps to increase their income-earning potential. While access to well-funded, high-quality health services should be available to the entire population, there are large disparities between urban and rural sectors, as well as across income quintiles. For instance, in several countries in the region there is a tendency to concentrate services in urban areas, which is a major reason explaining the lack of progress in the reduction of maternal mortality and infant mortality. Moreover, people often may not be able to afford health-care services even though they are available.

Economic growth without due consideration to environmental quality impacts both the ecology and imposes high costs to economies, while lowering the resilience of vulnerable populations given their environmentally degraded surroundings. Therefore, when moving up the development ladder, efforts must be made to safeguard the environment, and to increase access to basic services, such as electricity, clean drinking water and sanitation. Indeed, better access to these services also contributes to better health conditions. It is, therefore, important to consider *environmental* factors when considering just how inclusive growth has been. In this regard, while disaggregated data are less readily available, general improvements have been observed in, for instance, access to improved sanitation and water facilities, as well as access to cleaner energy – indicators that have important environmental impacts – with important differences, however, between rural and urban areas.

Overall inclusiveness

Any judgment call on whether growth has been inclusive in Asia and the Pacific becomes clouded once the multidimensional character of inclusiveness is considered. For example, while a country may have made significant advances in terms of social development, its success in accelerating poverty reduction or reducing income inequality may be less obvious. Indeed, even within each category of the three dimensions of development it may not be clear whether growth has been inclusive. For instance, in many countries significant declines in poverty rates have been accompanied by significant increases in income inequality.

Methodological and definitional perspectives on sustainable development, contained in the Rio+20 outcome document, offer an opportunity to compute a composite *index of inclusiveness*. This index consists of three sub-indices, one for each of the three dimensions of inclusiveness. Evidence for countries that have data to compute these sub-indices shows that between two periods of time, the 1990s and the period from 2000 to 2012, although growth across countries in the region has in general been more inclusive, significant divergences in inclusiveness exist within countries, between the sexes, across the rural and urban sectors and between regions. Particularly worrying is that the gap between the "haves" and the "have nots" within countries is widening. These dynamics, if they persist, will ultimately lead to a vicious cycle in which the better off benefit more from public services, such as health care and education, than do the less well off, which in turn increases their employment prospects, thereby widening the gap even further between them and those less well off.

A number of reasons have been put forward to explain the widening of income inequalities. These include market-oriented reforms that countries have embraced as they integrated more closely with the global economy. Although such reforms have resulted in higher economic growth rates, they have affected income distribution within countries by, for instance, contributing to a declining share of labour income in output and a widening of income inequality due to a more unequal distribution of capital. Other factors include procyclical fiscal policy stances, increased financialization of the international economy and the privatization of State-owned enterprises.

Policy considerations to improve inclusiveness

Some of the key policy considerations to make growth more inclusive include the need for countries to make expenditure more development-oriented, particularly by ensuring more equal access to education and health care and by providing stronger social safety nets. Moreover, access to financial services also needs to be broadened, particularly in rural sectors, to narrow the income gap between agricultural households and non-agricultural households. Countries will also need to support the infrastructure for sustained and inclusive growth by, for instance, providing important public infrastructure that will attract more investment into the rural sector.

Critically, greater efforts must be made to foster employment. In many countries this means giving greater attention to the development of small and medium-sized enterprises in general, and the rural sector, especially agriculture, in particular, by, for instance, fostering rural industrialization through small-scale industries.

While the private sector has an important role to play in making growth more inclusive, greater efforts are particularly needed of the public sector to lay the appropriate framework and create an enabling environment, especially as addressing *income inequalities* is a key entry point for increasing inclusiveness.

In conclusion, while growth in Asia and the Pacific has overall been inclusive across countries, between the 1990s and the period 2000-2012, the gap is widening between the “haves” and the “have nots” within countries. For instance, economic inclusiveness is largely a result of countries’ success in reducing rates of extreme poverty, masking the fact that compared with the 1990s, in most countries the richest 20% of the population are capturing a larger share of income than the poorest 20%. It also masks deterioration in labour markets, with fewer people being in formal employment. Similarly, despite a general improvement in access to health care and education, in all countries since the 1990s, opportunities within countries are determined largely by one’s economic circumstances, or those of one’s parents. Thus, concerted actions of the public and private sector are needed to address such concerns.

ACKNOWLEDGEMENTS

This report was prepared under the overall direction and guidance of Shamshad Akhtar, Under-Secretary-General of the United Nations and Executive Secretary of the Economic and Social Commission for Asia and the Pacific (ESCAP). The report was coordinated by a core team under the direction of Aynul Hasan, Director of the Macroeconomic Policy and Development Division. The core team led by Hamza Ali Malik, included Shuvojit Banerjee, Sudip Ranjan Basu, Steve Loris Gui-Diby, Daniel Jeongdae Lee, Oliver Paddison, Kiatkanid Pongpanich and Vatcharin Sirimaneetham. Others who contributed from the Division were Clovis Freire, Alberto Isgut, Zheng Jian, Syed Nuruzzaman, Naylin Oo, Katinka Weinberger and Marin Yari.

ESCAP staff who contributed substantively include: Muhammad Hussain Malik (former Section Chief) of the Macroeconomic Policy and Development Division; Rae Kwon Chung (Director), Hitomi Rankine, Sean Ratka and Jun Tian of the Environment and Development Division; Shamika N. Sirimanne (Director) of the Information and Communications Technology and Disaster Risk Reduction Division; Nanda Krairiksh (Director), Manuel Mejido, Jacqueline Paul and Vanessa Steinmayer of the Social Development Division; Anisuzzaman Chowdhury (Director) of the Statistics Division; Mia Mikic (Officer-in-Charge), Witada Anukoonwattaka, Adam H. Heal, Soo H. Kim, Rajan S. Ratna of the Trade and Investment Division; Yuwei Li (Director) of the Transport Division; Iosefa Maiava (Director) and Sanjesh Naidu of the ESCAP Pacific Office; Kilaparti Ramakrishna (Director) and Yejin Ha of the ESCAP Subregional Office for East and North-East Asia; Nikolay Pomoshchnikov (Director) of the ESCAP Subregional Office for North and Central Asia; and Nagesh Kumar (Director) and Matthew Hammill of the ESCAP Subregional Office for South and South-West Asia.

Valuable advice, comments and inputs were received from many staff of the United Nations who include Sukti Dasgupta and Phu Huynh of the International Labour Organization.

The following consultants provided inputs: Teguh Dartanto, Researcher, Institute for Economic and Social Research, Faculty of Economics, University of Indonesia, Jakarta; Sela Epeli, University of the South Pacific, Suva; Bakhodur Eshonov, Director, Center for Economic Research, Tashkent; Mohamad Ikhsan, Professor of Economics, University of Indonesia, Jakarta; Nanak Kakwani, Professor, University of New South Wales, Sydney, Australia; Saman Kelegama, Executive Director, Institute of Policy Studies of Sri Lanka, Colombo; Li Shi, Professor, Beijing Normal University, Beijing; Anawaite Matadradra, University of the South Pacific, Suva; Mustafa K. Mujeri, Director General, Bangladesh Institute of Development Studies, Dhaka; Vijay Naidu, Head, School of Government, Development and International Affairs, Faculty of Business and Economics, University of the South Pacific, Suva; Bishwambher Pyakuryal, Professor, Central Department of Economics, Tribhuvan University, Kathmandu; Mahendra Dev Suryadevara, Director (Vice Chancellor), Indira Gandhi Institute of Development Research, Mumbai, India; and Vo Tri Thanh, Vice President, Central Institute for Economic Management, Hanoi.

The report benefited from extensive comments and suggestions from an eminent group of policymakers, scholars and development practitioners, acting as external peer reviewers, namely: Sergey Afontsev, Department Director, Institute for World Economy and International Relations, Russian Federation; Mohamed Ariff, Professor, INCEIF University, Malaysia; Swati Banerjee, Chair and Associate Professor, Centre for Livelihoods and Social Innovation, School of Social Work, Tata Institute of Social Sciences, India; Leonor Magtolis Briones, Lead Convener, Social Watch, Philippines; Togtokh Chuluun, Science Advisor, Ministry of Environment and Green Development, Mongolia; Virginia Dandan, United Nations Independent Expert on Human Rights and International Solidarity, Philippines; Rosemarie G. Edillon, Assistant Director-General, National Economic and Development Authority, Philippines; Eric Kemp-Benedict, Centre Director, Asia, Stockholm Environment Institute, Thailand; Eetu Kuneinen, Co-founder, 3D Printing Industry, Thailand; Ikuo Kuroiwa, Executive Senior Research Fellow, Bangkok Research Centre, Institute of Developing Economies (IDE-JETRO), Thailand; Khotulyov Yevgeniy Leonidovich, Director, Macroeconomic Policy Department, Office of the Eurasian Economic Commission, Russian Federation; Li Xuesong, Deputy Director, Institute of Quantitative and Technical Economics, Chinese Academy of Social Sciences, China; Mark McGillivray, Research Professor of International Development, Alfred Deakin Research Institute, Deakin University, Australia; Nyingtob Pema Norbu, Economist, Macroeconomic Division, Gross National Happiness Commission, Bhutan; Lkhamsurengyn Nyamtseren, Board Member, Mongolian Development Institute, Mongolia; Simon Olsen, Senior Researcher, Institute for Global Environmental Strategies, Thailand; Benjamin Pereira, Assistant Governor, Central Bank of Samoa, Samoa; Jose A. Puppim de Oliveira, United Nations University (UNU-IAS), Japan; Celia M. Reyes, Senior Research Fellow, Philippine Institute for Development Studies, Philippines; Osborne Ogis Sanida, Senior Research Fellow and Program Leader, Economic Policy Research Program, National Research Institute, Papua New Guinea; Amphaphone Sayasenh, Researcher, International Economic Research Division, National Economic Research Institute, Lao People's Democratic Republic; Kris Schneider (Liu Min), Co-founder and Member of Advisory Board, ISA Industrial Ltd., (Holding), Austria; Anushree Sinha, Senior Fellow, National Council for Applied Economic Research, India; Abid Qaiyum Suleri, Executive Director, Sustainable Development Policy Institute, Pakistan; Sun-Jin Yun, Associate Professor, Graduate School of Environmental Studies, Seoul National University, Republic of Korea; Larissa Zelenina, Macroeconomic Policy Department, Office of the Eurasian Economic Commission, Russian Federation; and Uchita de Zoysa, Chairman, Global Sustainability Solutions, Sri Lanka.

Achara Jantarasaengaram, Chawarin Klongdee and Pannipa Jangvithaya of the Macroeconomic Policy and Development Division, ESCAP, provided research assistance.

The manuscript was edited by Robert Ruz and John Loftus, Editorial Unit of ESCAP. The graphic design was created by Natthakhom Jira, Taned Khongsathitsathaphorn and Wissuda Jittrailert, and the layout and printing were provided by Advanced Printing Service Co., Ltd.

Sutinee Yeamkitpibul, supported by Anong Pattanathanes and Nopharat Rojanasupsakul of the Macroeconomic Policy and Development Division, proofread the manuscript and undertook all administrative processing necessary for the issuance and launch of the publication.

Katie Elles, Francesca Ross and Chavalit Boonthanom of the ESCAP Strategic Communications and Advocacy Section coordinated the launch and dissemination of the report.

CONTENTS

CONTENTS *(continued)*

BOXES

FIGURES

FIGURES *(continued)*

TABLES

Page

EXPLANATORY NOTES

Analyses in the *Economic and Social Survey of Asia and the Pacific 2015* are based on data and information available up to the end of March 2015.

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, New Zealand and North and Central Asian economies
- Developed ESCAP region: Australia, Japan and New Zealand
- Least developed countries: Afghanistan, Bangladesh, Bhutan, Cambodia, Kiribati, Lao People's Democratic Republic, Myanmar, Nepal, Solomon Islands, Timor-Leste, Tuvalu and Vanuatu. Samoa was part of the least developed countries prior to its graduation in 2014.
- Landlocked developing countries: Afghanistan, Armenia, Azerbaijan, Bhutan, Kazakhstan, Kyrgyzstan, Lao People's Democratic Republic, Mongolia, Nepal, Tajikistan, Turkmenistan and Uzbekistan
- East and North-East Asia: China; Democratic People's Republic of Korea; Hong Kong, China; Japan; Macao, China; Mongolia and the Republic of Korea
- North and Central Asia: Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Russian Federation, Tajikistan, Turkmenistan and Uzbekistan
- Pacific: American Samoa, Australia, Cook Islands, Fiji, French Polynesia, Guam, Kiribati, Marshall Islands, Micronesia (Federated States of), Nauru, New Caledonia, New Zealand, Niue, Northern Marina 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.
  Bibliographical and other references have not been verified. The United Nations bears no responsibility for the availability or functioning of URLs.

The designations employed and the presentation of the material in this publication do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area, or of its authorities, or concerning the delimitation of its frontiers or boundaries.

Mention of firm names and commercial products does not imply the endorsement of the United Nations.

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 fiscal years, currencies and 2013 exchange rates of the economies in the ESCAP region are listed in the following table:

Country or area in the ESCAP region	*ISO Alpha-3 code*	*Fiscal year*	*Currency and abbreviation*	*Rate of exchange for $1 as at December 2014*
Afghanistan	AFG	21 March to 20 March	afghani (Af)	57.82
American Samoa	ASM	..	United States dollar ($)	1.00
Armenia	ARM	1 January to 31 December	dram	474.97
Australia	AUS	1 July to 30 June	Australian manat ($A)	1.22
Azerbaijan	AZE	1 January to 31 December	Azerbaijan manat (AZM)	0.78
Bangladesh	BGD	1 July to 30 June	taka (Tk)	77.95
Bhutan	BTN	1 July to 30 June	ngultrum (Nu)	63.33
Brunei Darussalam	BRN	1 January to 31 December	Brunei dollar (B$)	1.32
Cambodia	KHM	1 January to 31 December	riel (CR)	4 075.00
China	CHN	1 January to 31 December	yuan (Y)	6.12
Cook Islands	COK	1 April to 31 March	New Zealand dollar ($NZ)	1.28
Democratic People’s Republic of Korea	PRK	..	won (W)	..
Fiji	FJI	1 January to 31 December	Fiji dollar (F$)	1.99
French Polynesia	PYF	..	French Pacific Community franc (FCFP)	87.11
Georgia	GEO	1 January to 31 December	lari (L)	1.86
Guam	GUM	1 October to 30 September	United States dollar ($)	1.00
Hong Kong, China	HKG	1 April to 31 March	Hong Kong dollar (HK$)	7.76
India	IND	1 April to 31 March	Indian rupee (Rs)	63.33
Indonesia	IDN	1 April to 31 March	Indonesian rupiah (Rp)	12 440.00
Iran (Islamic Republic of)	IRN	21 March to 20 March	Iranian rial (Ris)	27 138.00
Japan	JPN	1 April to 31 March	yen (¥)	120.64
Kazakhstan	KAZ	1 January to 31 December	tenge (T)	182.35
Kiribati	KIR	1 January to 31 December	Australia dollar ($A)	1.22
Kyrgyzstan	KGZ	1 January to 31 December	som (som)	58.89
Lao People’s Democratic Republic	LAO	1 October to 30 September	kip (NK)	8 097.77
Macao, China	MAC	1 July to 30 June	pataca (P)	7.99
Malaysia	MYS	1 January to 31 December	ringgit (M$)	3.50
Maldives	MDV	1 January to 31 December	rufiyaa (Rf)	15.40
Marshall Islands	MHL	1 October to 30 September	United States dollar ($)	1.00
Micronesia (Federated States of)	FSM	1 October to 30 September	United States dollar ($)	1.00
Mongolia	MNG	1 January to 31 December	tugrik (Tug)	1 885.60
Myanmar	MMR	1 April to 31 March	kyat (K)	1 031.50
Nauru	NRU	1 July to 30 June	Australian dollar ($A)	1.23
Nepal	NPL	16 July to 15 July	Nepalese rupee (NRs)	101.42
New Caledonia	NCL	..	French Pacific Community franc (FCFP)	87.11
New Zealand	NZL	1 April to 31 March	New Zealand dollar ($NZ)	1.28
Niue	NIU	1 April to 31 March	New Zealand dollar ($NZ)	1.28
Northern Mariana Islands	MNP	1 October to 30 September	United States dollar ($)	1.00
Pakistan	PAK	1 July to 30 June	Pakistan rupee (PRs)	100.46
Palau	PLW	1 October to 30 September	United States dollar ($)	1.00
Papua New Guinea	PNG	1 January to 31 December	kina (K)	2.59

Country or area in the ESCAP region	*ISO Alpha-3 code*	*Fiscal year*	*Currency and abbreviation*	*Rate of exchange for $1 as at December 2014*
Philippines	PHL	1 January to 31 December	Philippine peso (P)	44.62
Republic of Korea	KOR	1 January to 31 December	won (W)	1 099.30
Russian Federation	RUS	1 January to 31 December	ruble (R)	56.26
Samoa	WSM	1 July to 30 June	tala (WS$)	2.42
Singapore	SGP	1 April to 31 March	Singapore dollar (S$)	7.36
Sri Lanka	LKA	1 January to 31 December	Sri Lanka rupee (SL Rs)	131.05
Tajikistan	TJK	1 January to 31 December	somoni	5.31
Thailand	THA	1 October to 30 September	baht (B)	32.96
Timor-Leste	TLS	1 July to 30 June	United States dollar ($)	1.00
Tonga	TON	1 July to 30 June	pa’anga (T$)	1.95
Turkey	TUR	1 January to 31 December	Turkish lira (LT)	2.32
Turkmenistan	TKM	1 January to 31 December	Turkmen manat (M)	2.85
Tuvalu	TUV	1 January to 31 December	Australian dollar ($A)	1.23
Uzbekistan	UZB	1 January to 31 December	Uzbek som (som)	2 418.00
Vanuatu	VUT	1 January to 31 December	vatu (VT)	102.72
Viet Nam	VNM	1 January to 31 December	dong (D)	21 246.00

Sources: United Nations, Monthly Bulletin of Statistics website, http://unstats.un.org/unsd/mbs/app/DataSearchTable.aspx, 31 March 2015; and national sources.

ABBREVIATIONS

ADB	Asian Development Bank
AEC	ASEAN Economic Community
AIIB	Asian Infrastructure Investment Bank
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
CLMV	Cambodia, Lao People's Democratic Republic, Myanmar and Viet Nam
CO2	carbon dioxide
COP 21	twenty-first session of the Conference of the Parties
CPI	consumer price index
ECAFE	Economic Commission for Asia and the Far East
ESCAP	Economic and Social Commission for Asia and the Pacific
FDI	foreign direct investment
FTA	free trade agreement
FTAAP	free trade area of the Asia-Pacific
GDP	gross domestic product
GHG	greenhouse gas
GII	gender inequality index
HDI	human development index
IEA	International Energy Agency
ILO	International Labour Organization
IMF	International Monetary Fund
KDI	Korea Development Institute
LNG	liquefied natural gas
MPI	multidimensional poverty index
NDB	New Development Bank
OECD	Organisation for Economic Co-operation and Development
PPP	purchasing power parity
PPPs	public-private partnerships
RCEP	Regional Comprehensive Economic Partnership
SMEs	small and medium-sized enterprises
TFA	Trade Facilitation Agreement
TPES	total primary energy supply
TPP	trans-Pacific partnership
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNFCCC	United Nations Framework Convention on Climate Change
UN-HABITAT	United Nations Human Settlements Programme
UNSDSN	United Nations Sustainable Development Solutions Network
WHO	World Health Organization
WTO	World Trade Organization

1

ECONOMIC GROWTH OUTLOOK AND KEY CHALLENGES

The pursuit of inclusive growth and sustainable development has gained global momentum with unprecedented efforts across institutions and societies. The United Nations Summit, to be held in September this year, will discuss the post-2015 development agenda and adopt a set of sustainable development goals as mandated by the United Nations Conference on Sustainable Development held in Rio de Janeiro, Brazil, in 2012. Supporting this endeavor, global leaders will meet in Addis Ababa in July 2015 for the Third Conference on Financing for Development to lay out a framework for financing for development to meet the requirements of the new agenda.

Global leaders have been further engaged in discussing the challenges of human-induced climate change. In the twenty-first session of the Conference of the Parties (COP 21) to the United Nations Conference on Climate Change, to be held in Paris in December this year, expectations are high regarding new arrangements for climate change with supportive climate finance. Within the Asia-Pacific region, the Association of Southeast Asian Nations (ASEAN) is set to form the ASEAN Economic Community (AEC) by the end of the year which, among others, is working closely with the United Nations to galvanize support for the emerging post-2015 development agenda.

Against this backdrop, the *Economic and Social Survey of Asia and the Pacific 2015* provides an analysis of the prospects for economic growth in the region, while highlighting major risks and challenges as well as discussing some key policy options. A central issue explored in the *Survey* is that, while the policy focus on economic growth is necessary, it is definitely not sufficient, to achieve “development”. Policymakers in the region will have to internalize the aspects of inclusive growth and sustainable development within their policy frameworks in order to surmount the emerging challenges articulated in the proposed sustainable development goals.[1]

Economic growth in the developing economies of the region is expected to increase slightly in

2015. Growth will be driven more by domestic and intraregional factors than external factors as the prospects for a global economic recovery are likely to remain fragile. Economic growth in the region currently is being supported by accommodative monetary and fiscal policies in many economies and ongoing efforts in structural reform programmes. The recent oil price decline has offered relief to oil import-dependent economies, while straining structural imbalances of oil exporting economies. Besides creating fiscal space, the oil price decline has lowered inflation across the board except in economies struggling to cope with revenue losses related to oil. Release of resources in oil importing countries following decline in oil prices and the opportunity to dismantle or scale down fuel subsidies offer a one-time opportunity to invest in infrastructure and support inclusive growth measures.

Despite the modest improvement in the economic outlook for the region, growth is below pre-crisis level and below the potential of the region, and lacks inclusiveness and sustainability. The growth potential of economies is being held back by structural weaknesses including infrastructure shortages and the excessive commodity-dependence of some economies. The fragile global economic recovery is not helping growth prospects either. Unless reforms are vigorously pursued, downside risks to the growth trajectory could increase.

Domestic problems at this stage far outweigh external dynamics. However, two key external risks remain on the horizon. First, the growth in trade continues to be below pre-crisis levels and the cushion of intraregional trade is likely to be impacted if the slowdown in the large export oriented economic bloc of the Asia-Pacific region persists or magnifies. Second, the evolving global monetary policy conditions are creating complications for emerging markets by offering alternate investment opportunities in asset markets. For instance, there remains a near term certainty of Japan and the eurozone continuing with monetary easing. On the other hand, while signaling the direction towards monetary tightening, the actions and timing of the United States Federal Reserve are likely to be driven by emergence of robust signs of pick up in the United States economy.

Deceleration in economic activity in the Asia-Pacific region and complexity and delays in the full unwinding of deleveraging in the private sector will impact the global growth momentum. Timing and sequencing of policies pursued will matter since markets in the region remain vulnerable to capital outflows and asset market volatility, strongly driven by investor sentiments regarding monetary tightening in the United States. This could create macroeconomic and financial instability, particularly for economies with weak fundamentals and political difficulties. A comforting factor this time round is improvement in current account balances of oil importing countries due to declining oil prices, though recovery in exports is modest despite appreciation of the United States dollar. Developing economies in the region have strengthened their capacities to implement macroprudential policies, such as caps on loan-to-value ratios, limits on certain segments of credit growth and capital and reserve requirements, which offer approaches to manage the implications of capital flow volatility. Unlike interest rate adjustments and interventions in the foreign exchange market, macroprudential measures directly target the source of instability of capital flow volatility, namely the domestic asset markets in which capital flows are invested, and thus help in containing market disruptions and enhancing stability.

Growth has not been fully inclusive as gains from it have not been widely shared. Most worrisome is the high and growing inequalities in the region both in terms of incomes and opportunities as well as in terms of disparities between the different geographic locations and sections of society, such as rural and urban areas and women and men. The lack of sustainability of economic growth is further validated by trends in environmental damage, resource use and the resource intensity of growth, lack of progress on accelerating action on climate issues and persistent gender inequalities, among other concerns.[2]

In view of these challenges, a number of policy considerations emerge. One such consideration is the need to establish an enabling policy and institutional environment to support the flow of innovative and equitable finance for implementation of an ambitious sustainable development agenda, as discussed in the theme study for the seventy-first session of the Commission (ESCAP, forthcoming, a). A second consideration is the need for well-thought-out macroprudential measures to manage capital volatility, thus supporting economic stability and providing a resilient platform for inclusive growth. The imperative for commodity-dependent economies to diversify their economies into other sectors is the third area that requires investigation. Similarly, policies aimed at increasing the inclusiveness of growth are also highlighted. Finally, some innovative actions that could be taken by economies in the region to better address climate change, particularly topical in the run-up to the previously mentioned conference on climate change in Paris, are also discussed.

The first section contains a discussion of the macroeconomic outlook for the region in 2015 and 2016. The section contains: (a) the latest forecasts for economic growth and inflation; (b) an analysis of recent domestic macroeconomic and reform policies of Governments; and (c) an update on trade, foreign investment and financial market developments. The second section contains consideration of some of the risks and challenges to the economic outlook, stemming from both domestic and external sources. In the domestic sphere, structural concerns are highlighted in terms of infrastructure deficiencies and lack of diversification of commodity-dependent economies; in the external sphere, risks from global monetary policy developments and the domestic implications of oil price developments are discussed. The final section contains a number of policy considerations and suggestions on: (a) dealing with obstacles holding back the inclusive aspects of growth; (b) mobilizing financing for the sustainable development agenda; (c) use of effective macroprudential measures as part of a toolkit to manage capital volatility; (d) policies to encourage diversification of commodity-dependent economies; and (e) addressing climate change concerns and issues of sustainable energy.

1. MACROECONOMIC OUTLOOK AND PERFORMANCE

1.1. Growth and inflation

Economic growth in the developing economies in Asia and the Pacific is expected to increase only slightly in 2015 – to 5.9%, up from 5.8% in 2014 (see table 1.1).[3] This outlook is based on relatively improved economic performance in a number of major developing economies, including Bangladesh, India, Indonesia, Papua New Guinea, the Republic of Korea and Thailand. Some of these economies are undertaking reform programmes under new administrations, which are expected to generate positive results in 2015. Meanwhile, the outlook for some exporting economies remains less upbeat due to slow growth in the eurozone and Japan, as well as in China which is the major source of intraregional final demand. Despite only a moderate increase in economic growth in developing economies, excluding those in North and Central Asia, the region will continue to lead the global economic recovery, with growth in 2015 expected to be nearly two and a half times greater than in the major global developed economies (see figure 1.1). Nevertheless, it is also the case that the growth differential between the region and the developed world is becoming smaller compared with the pre-crisis period when growth in the region was more than three times faster. The narrowing differential is due to a slowdown in the region and to the fact that the developed economies have returned to growth that is close to their pre-crisis levels. Thus, unless comprehensive and concerted reforms are vigorously pursued, downside risks to the growth trajectory of developing economies of the region could increase.

At the subregional level, growth performance is forecast to vary depending on the relative importance of domestic and external demand for particular subregions. **South and South-West Asia,** where domestic demand plays an important role, is expected to enjoy an economic growth rate of 5.9% in 2015 – a four-year high – up from 5.5% in 2014 (see figure 1.2).[4] This rise in the growth rate is due to an expected higher level of growth in the larger economies in the region, with improved performance in all economies, except the Islamic Republic of Iran and Nepal. On the other hand, East and North-East Asian and South-East Asian economies, for which exports play an important role, are forecast to record a much more modest growth performance. Growth in **East and North-East Asia** is expected to increase only slightly to 3.4% in 2015, up from 3.3% in 2014, largely due to relatively better growth in Japan as a result of domestic macroeconomic stimulus. This will help to overcome lower growth in China as the economy rebalances from an investment and export-led growth model towards a domestic consumption oriented approach to economic growth. For **South-East Asia,** the forecast is for growth to increase to 4.9% in 2015, up from 4.3% in 2014, although growth in many export-led economies may only rise modestly. Improved growth performance in the subregion is mostly due to the performance of the more domestic demand-led economy of Indonesia. Thailand's economy is also expected to witness a pickup in 2015 after

Table 1.1. Rates of economic growth and inflation in selected economies of the ESCAP region, 2013-2016

(Percentage)	Average pre-crisis growth 2005-2007	Real GDP growth				Inflation[a]			
		2013	2014[b]	2015[c]	2016[c]	2013	2014[b]	2015[c]	2016[c]
East and North-East Asia[d]	**6.7**	**4.2**	**3.3**	**3.4**	**3.5**	**1.5**	**2.3**	**1.4**	**2.4**
East and North-East Asia (excluding Japan)[d]	**10.9**	**6.6**	**6.3**	**6.0**	**6.0**	**2.4**	**2.0**	**1.8**	**2.6**
China	12.7	7.7	7.4	7.0	6.8	2.6	2.0	1.7	2.5
Demographic People's Republic of Korea	0.5	..	..	..	..	..	..	..	..
Hong Kong, China	6.8	2.9	2.3	2.5	2.8	4.3	4.4	3.5	3.2
Japan	2.1	1.6	-0.1	0.6	0.8	0.4	2.7	1.0	2.2
Macao, China	16.5	10.7	-0.4	-4.0	8.0	5.5	6.0	4.3	5.0
Mongolia	8.7	11.7	7.8	3.5	5.0	8.6	12.8	8.5	7.7
Republic of Korea	4.8	3.0	3.3	3.4	3.7	1.3	1.3	1.9	2.6
North and Central Asia[d]	**8.5**	**2.1**	**1.3**	**-2.9**	**-0.8**	**6.7**	**7.6**	**12.2**	**9.6**
North and Central Asia (excluding Russian Federation)[d]	**13.0**	**6.5**	**5.1**	**3.2**	**4.0**	**5.9**	**6.5**	**7.5**	**7.3**
Armenia	13.6	3.5	3.4	0.9	2.3	5.8	3.0	4.7	4.0
Azerbaijan	28.6	5.8	2.8	2.3	2.5	2.4	1.5	7.3	5.7
Georgia	10.4	3.3	4.7	4.5	4.8	-0.5	3.1	5.0	5.0
Kazakhstan	9.8	6.0	4.3	1.5	2.9	5.8	6.7	5.7	6.2
Kyrgyzstan	3.8	10.5	3.6	2.0	2.5	6.6	7.5	10.7	9.0
Russian Federation	7.7	1.3	0.6	-4.0	-1.6	6.8	7.8	13.0	10.0
Tajikistan	7.2	7.4	6.7	4.0	4.8	5.0	6.1	10.1	8.0
Turkmenistan	12.0	10.2	10.3	9.5	9.2	9.0	11.0	12.0	11.3
Uzbekistan	7.9	8.0	8.1	7.1	7.2	11.2	11.7	12.0	12.2
Pacific[d]	**3.4**	**2.4**	**2.6**	**2.5**	**3.1**	**2.3**	**2.4**	**1.8**	**2.4**
Pacific island developing economies[d]	**3.2**	**4.0**	**6.0**	**9.7**	**4.4**	**3.9**	**4.2**	**4.5**	**4.5**
Cook Islands	1.2	-1.7	-1.2	2.1	-0.3	2.6	1.6	1.3	1.4
Fiji	-0.1	4.6	4.2	4.0	4.0	2.9	0.5	2.5	2.5
Kiribati	2.1	2.4	3.0	1.5	1.5	-1.5	2.6	1.0	1.5
Marshall Islands	2.0	3.0	0.5	3.5	1.5	1.9	1.3	1.4	1.3
Micronesia (Federated State of)	0.2	-4.0	-3.4	2.3	5.1	2.1	0.7	2.4	2.6
Nauru	-11.8	4.5	10.0	8.0	5.0	1.4	5.0	8.0	3.0
Palau	3.4	-1.7	6.9	8.0	6.0	2.8	4.0	3.4	3.4
Papua New Guines	4.5	5.1	8.4	15.0	5.0	5.0	6.6	6.0	6.0
Samoa	3.7	-1.1	1.9	2.5	2.2	0.6	-0.4	2.5	2.0
Solomon Islands	6.4	2.9	-0.2	3.0	3.5	5.4	6.0	5.0	5.5
Tonga	-1.3	-2.7	2.1	2.4	2.6	0.8	2.5	0.4	1.0
Tuvalu	2.7	1.3	2.0	2.0	2.0	2.0	3.3	1.0	1.0
Vanuata	6.3	2.0	3.6	-0.5	4.0	1.4	0.3	4.0	2.0
Developed countries (Australia and New Zealand)[d]	**3.4**	**2.4**	**2.6**	**2.4**	**3.1**	**2.2**	**2.3**	**1.8**	**2.3**
Australia	3.4	2.4	2.5	2.3	3.0	2.4	2.5	2.0	2.5
New Zealand	3.0	2.5	3.0	3.0	3.5	1.1	1.2	0.1	1.3
South and South-West Asia[d,e]	**8.1**	**5.1**	**5.5**	**5.9**	**6.1**	**11.2**	**8.3**	**6.9**	**6.8**
Afganistan	10.2	3.6	3.2	4.5	5.0	7.4	5.0	5.0	5.0
Bangladesh	6.3	6.0	6.1	6.3	6.5	7.7	7.4	6.5	6.2
Bhutan	10.6	4.2	6.0	6.8	7.0	8.8	8.3	7.0	7.0
India		6.9	7.4	8.1	8.2	9.5	6.6	5.5	5.8
Iran (Islamic Republic of)	6.1	-1.9	1.9	0.9	1.3	34.7	17.2	16.0	14.1
Maldives	7.2	8.8	8.5	10.5	7.1	3.8	2.4	3.1	3.0
Nepal	3.3	3.9	5.5	5.0	4.7	9.9	9.0	7.8	6.9
Pakistan	7.2	3.7	4.1	5.1	4.8	7.4	8.6	5.5	5.8
Sri Lanka	6.9	7.2	7.4	7.5	7.6	6.9	3.3	3.0	5.0
Turkey	6.7	4.2	2.9	3.3	3.7	7.5	8.9	7.0	6.5
South-East Asia[d]	**6.1**	**5.0**	**4.3**	**4.9**	**5.1**	**4.0**	**3.8**	**2.9**	**3.3**
Brunei Darussalam	1.7	-1.8	1.1	1.5	2.0	0.4	-0.8	0.2	0.5
Cambodia	11.4	7.4	7.2	7.3	7.4	3.0	3.9	2.0	3.0
Indonesia	5.8	5.8	5.0	5.6	5.8	6.4	6.4	5.5	5.0
Lao People's Democratic Republic	7.7	8.5	7.5	7.2	7.2	6.4	4.2	3.5	4.0
Malaysia	5.9	4.7	6.0	4.9	5.2	2.1	3.1	3.0	2.9
Myanmar	12.9	8.3	7.8	8.3	8.2	5.7	5.9	8.0	6.5
Philippines	5.8	7.2	6.1	6.5	6.4	3.0	4.1	3.0	3.2
Singapore	7.8	4.4	2.9	3.1	3.5	2.4	1.0	0.3	1.5
Thailand	4.9	2.9	0.7	3.9	4.0	2.2	1.9	0.3	2.0
Timor-Leste[f]	5.0	5.4	7.1	6.5	6.5	9.5	1.0	2.5	3.5
Viet Nam	8.4	5.4	6.0	6.1	6.2	6.6	4.1	2.5	4.0
Memorandum items:									
Developing ESCAP economies (excluding North and Central Asia)	**9.5**	**6.0**	**5.8**	**5.9**	**5.9**	**5.0**	**3.9**	**3.3**	**3.8**
Developing ESCAP economies (including North and Central Asia)	**9.4**	**5.5**	**5.3**	**4.9**	**5.2**	**5.2**	**4.3**	**4.3**	**4.4**
Least developed countries[g]	**6.0**	**5.4**	**5.6**	**5.7**	**5.8**	**6.8**	**6.4**	**5.5**	**5.4**
Landlocked developing countries	**11.7**	**6.2**	**4.9**	**3.2**	**3.9**	**6.1**	**6.5**	**7.1**	**6.9**
Small island developing States	**3.7**	**4.6**	**6.3**	**9.6**	**4.8**	**4.2**	**3.8**	**4.3**	**4.3**
Developed ESCAP economies	**2.3**	**1.7**	**0.3**	**0.9**	**1.2**	**0.7**	**2.6**	**1.1**	**2.2**
Total ESCAP	**6.8**	**4.1**	**3.5**	**3.4**	**3.7**	**3.6**	**3.7**	**3.1**	**3.6**

Sources: ESCAP, based on national sources; United Nations, Department of Economic and Social Affairs,. *World Economic Situation and Prospects 2015*, (Sales No. E.15. II.C.2). Available from www.un.org/en/development/desa/policy/wesp/wesp_current/wesp2015.pdf; IMF, International Financial Statistics databases. Available from http://elibrary-data.imf.org; ADB, *Asian Development Outlook 2015* (Manila, 2015); CEIC Data. Available from www.ceicdata.com; and web site of the Interstate Statistical Committee of the Commonwealth of Independent States. Available from www.cisstat.com.

[a] Changes in the consumer price index.

[b] Estimates.

[c] Forecasts (as of 31 March 2015).

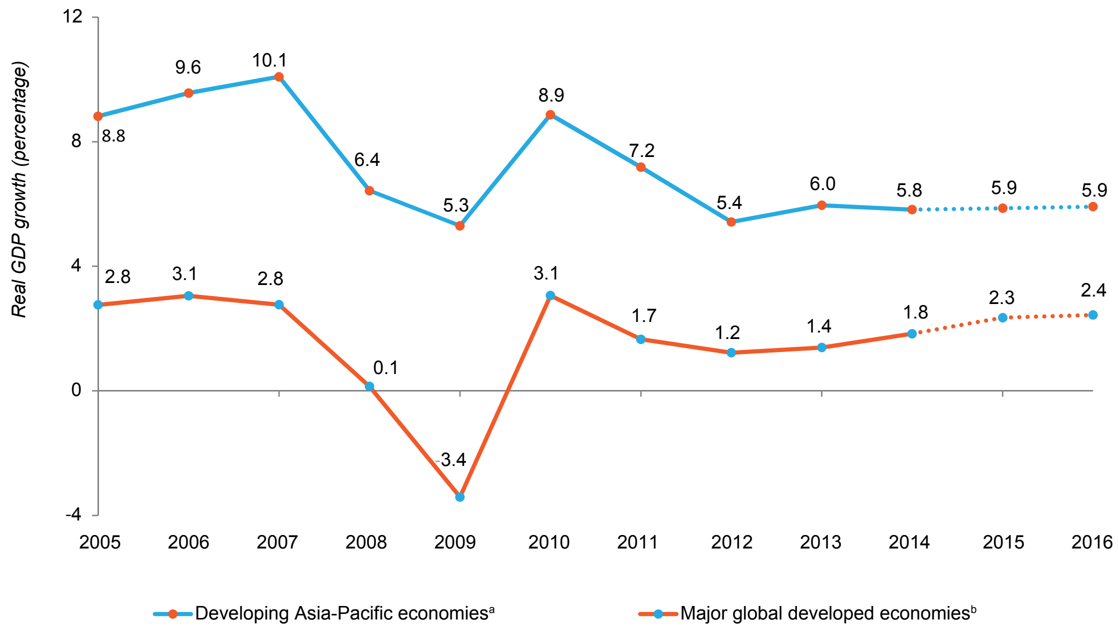
[d] GDP figures at market prices in United States dollars in 2010 (at 2005 prices) used as weights to calculate the regional and subregional aggregates.

[e] The estimates and forecasts for countries relate to fiscal years defined as follows: 2014 refers to the fiscal year spanning the period from 1 April 2014 to 31 March 2015 in India and Myanmar; from 21 March 2014 to 20 March 2015 in Afghanistan and the Islamic Republic of Iran; from 1 July 2013 to 30 June 2014 in Bangladesh, Bhutan and Pakistan; and from 16 July 2013 to 15 July 2014 in Nepal.

[f] Non-oil GDP

[g] Samoa is excluded from the calculation for 2014 onwards due to its graduation from the least developed country category.

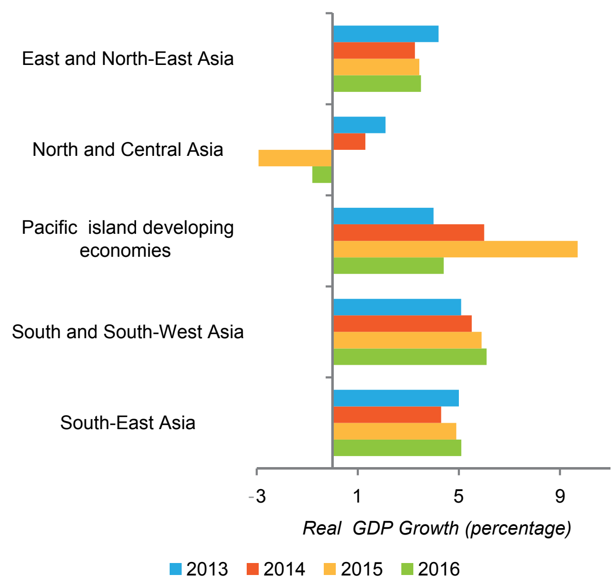
Figure 1.1. Growth in developing Asia-Pacific economies and major global developed economies, 2005-2016



Sources: ESCAP, based on national sources and CEIC Data. Available from www.ceicdata.com (accessed 30 March 2015); forecasts for major developed economies are based on IMF, World Economic Outlook database.

Note: [a] Developing Asia-Pacific economies comprise 37 economies, excluding those in North and Central Asia. The series reflects the revised estimates of GDP growth for India from 2012 onwards. The revised estimates entail shifting of the base year from 2004/05 to 2011/12 and also deploying improved methodologies. The major changes incorporated in the revision include the use of GDP at constant market prices rather than factor price at constant price to comply with international standards; sector-wise estimates of gross value added are now given at basic prices rather than at factor cost; and more comprehensive coverage of the corporate and financial sectors as well as the local bodies and autonomous institutions. Caution should be exercised in comparing growth rates between the earlier series and the revised series.
[b] Major developed economies comprise 36 economies, including Japan, the United States and the 18 countries belonging to the eurozone.

Figure 1.2. Growth in ESCAP subregions, 2013-2016



Source: Based on table 1.

near-zero growth in 2014 due to political instability. Unlike other subregions, **North and Central Asia** is forecast to see a substantial contraction of 2.9% in economic activity, which is significant when viewed in the context of a 1.3% rise in real GDP in 2014. This captures the expected contraction of the economy of the Russian Federation and its spillovers into trade and remittance channels to countries with strong economic dependence on the Russian Federation. Finally, economic growth in the **Pacific island developing economies** is expected to increase dramatically to 9.7% in 2015, up from 6% in 2014, led by the strong performance of Papua New Guinea due to the commencement of liquefied natural gas production and export.

In terms of some country examples, economic growth in **India** is forecast to increase to 8.1% in 2015, using rebased national income accounts estimates, up from 7.4% in 2014.[5] Part of this growth is also driven by the positive impact of lower international oil prices, which has facilitated the removal of fuel subsidies. The fiscal space thus created eased borrowings from the central bank, allowing room for accommodative monetary policy. It must be remembered that short-term stimulus to economic performance can only generate a sustained higher growth trajectory if it is supported by implementation of the Government's promises to deliver a structural reform package. Some measures, such as the lifting of barriers to foreign investment, could be undertaken relatively rapidly; however, other measures involving a considerable number of legislative steps could be implemented on a multi-year basis.

Similarly, growth in **Indonesia** is expected to improve to a rate of 5.6% in 2015, after having decelerated in 2014 to its slowest rate in five years at 5%. Prospects for higher growth will depend on how diligently and swiftly a far-reaching and multi-year reform programme is delivered under the country's new administration. Besides cuts to fuel subsidies, improved tax collection, accelerated infrastructure development and improvements in the investment climate are on the cards. The **Philippines** will be another strong performer in 2015, with growth forecast to expand by 6.5% relative to 6.1% growth in 2014. Domestic consumption will remain the main driver of growth aided further by the fall in global oil prices and continued good performance in the services sector, which is the largest contributor to the economy. The Government is likely to expand fiscal spending in the run-up to elections in 2016.

Weighing on regional aggregate growth is the performance of economies dependent on exporting directly to the developed economies and through the conduit of re-exports from China, which will experience relatively constrained growth. Sustainability considerations have driven a slowdown in economic growth in **China**, expected to be 7% in 2015, which is less than the rate of 7.4% in 2014. The growth in 2014 represented the slowest growth rate since 1990 as the Government continued on its path of rebalancing the economy towards fostering a greater role for domestic consumption. Skillful management of supportive monetary and fiscal policies in 2015 is likely to safeguard growth trends so as not to jeopardize social objectives. Monetary policies will have to be calibrated to manage the risk of an increase in non-performing loans in the banking system and fiscal policy will need to be directed in order to keep investment rates within sustainable and manageable limits. Slow growth in the economy will have spillovers throughout the region — economies most affected will be those that are traditional exporters of commodities and intermediate goods, which have served to satisfy final demand in China, as well as production for re-export from China.

Economies critically dependent on oil production revenue sources will not only struggle to manage their growth and macroeconomic fundamentals but would also act as a drag on their neighbours. These economies include the Russian Federation and North and Central Asian countries that are oil producers or closely linked to the economy of the **Russian Federation,** as well as the Islamic Republic of Iran and Malaysia. The economy of the Russian Federation is expected to contract by 4% in 2015 after experiencing a modest growth rate of 0.6% in 2014. The downturn in oil prices together with geopolitical sanctions has continued to exert a strong negative impact on the economy of the Russian Federation. The fall in oil prices resulted in loss of the country's oil-related tax collection, which in turn adversely affected the Government's budgetary spending. At the same time, fall in export earnings has strained the current account balance. Both macroeconomic and political complications resulted in exchange rate depreciation that in turn led to higher prices for imported goods and lower consumption. Economic sanctions and financial difficulties of oil companies have also exerted a considerable burden on the banking sector's operations and may prove to be a drag on growth performance in 2015. The contraction in the

Russian Federation will exert a significant impact on other economies in the subregion through trade and remittance ties and will contribute to reduced growth in a number of those economies. Growth in **Malaysia** is expected to grow at a slower pace of 4.9% as compared with 6% in 2014, with falling oil prices being an important factor for this oil-exporting country. Other than the negative impacts on growth through the export channel, reduced tax receipts from the oil sector may widen the budget deficit in the country if the Government carries on with its previously announced spending plans.

The outlook for inflation is better than that for economic growth. Inflation in the developing economies of the region is expected to decline noticeably to 3.3% in 2015 from the rate of 3.9% in 2014.[6] This trend is primarily driven by lower international oil prices and reduced demand pressure in export-led economies. As the majority of the economies in Asia and the Pacific are net oil importers, the decline in oil prices is expected to restrain inflationary pressures in the region as a whole. This, however, will not be the case for the oil-exporting economies, such as the Islamic Republic of Iran and the Russian Federation. Reduced oil exports have already and will continue to put downward pressure on these countries' currencies, which in turn could result in imported inflation. In addition, domestic demand was kept contained by relatively tight monetary policy in economies which had displayed high inflation.

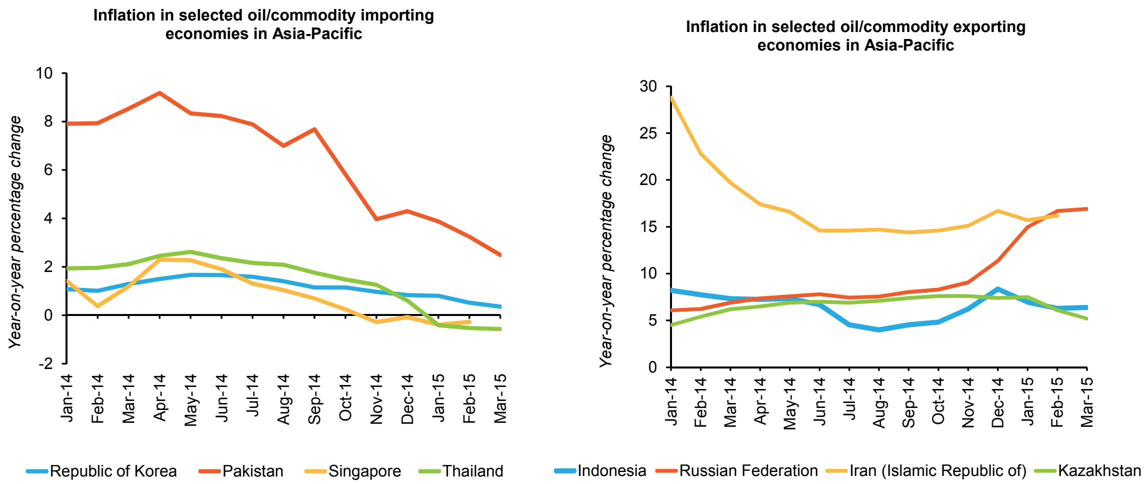
For the subregions, there will be varying performances in terms of inflation. In the **North and Central Asian** subregion, weakening of fundamentals could raise the inflation rate to 12.2% in 2015 compared with the rate of 7.6% in 2014. Economies in **South and South-West Asia** will also continue to experience somewhat high inflation, particularly due to high domestic demand relative to constrained supply. Encouragingly, even though the level of inflation remains relatively high compared with some other subregions, it is expected to decline from 8.3% in 2014 to 6.9% in 2015. This is the lowest rate in four years in the subregion, led by decreases in Bangladesh, India and Pakistan due to both lower oil prices and relatively tight monetary policy. Inflation in **South-East Asia** and **East and North-East Asia,** where exports play an important role in many economies, is forecast to be generally subdued as total demand is constrained in line with relatively weak export demand from major developed economy trading partners.

1.2. Macroeconomic policies and reform initiatives

With inflation trending downwards in many economies, there is scope for reductions in interest rates to help boost domestic demand (see figure 1.3). In fact, in a number of economies in 2015, such considerations have already led to significant adjustments in monetary policy towards a more accommodative stance. Lower inflation together with more accommodative monetary policies may support overall growth by encouraging investment and positively affect exports by encouraging lower exchange rates. Nevertheless, given the concerns regarding capital outflow and high debt levels in some economies, the monetary policy stance will have to be calibrated much more cautiously in going forward.

Following a 100 basis point reduction in the policy rate announced in January 2015, **Pakistan** lowered its policy rate by another 50 basis points to 8.0% in March 2015, the lowest since 2005. **Turkey** also lowered its one-week benchmark rate by another 50 basis points to 7.5% in April 2015. Similarly, **India** lowered its repo rate by 25 basis points to 7.75% and its reverse repo rate by 25 basis points to 6.75% in January 2015, and it lowered its repo rate by an additional 25 basis points to 7.5% in March 2015. **Indonesia** cut its key reference rate by 25 basis points to 7.5% in February 2015. **Singapore** in January 2015 loosened its monetary policy through its main tool of reducing the slope of its currency band, thereby allowing for greater depreciation in its currency. **China** in February 2015 lowered its required reserve ratio for banks by 0.5% to 19.5%, as well as enacted further targeted cuts for so-called city commercial banks, which lend more commonly to small businesses and the agricultural sector in order to spur growth in the economy through these investment channels. China in March 2015 subsequently cut its benchmark one-year lending interest rate by 25 basis points to 5.35% and the benchmark savings rate by 25 basis points to 2.5%, after having previously lowered the two rates by 40 basis points and 25 basis points, respectively, in November 2014. **Thailand** cut its policy rate in March 2015 by 25 basis points to 1.75%. The **Russian Federation** also lowered its interest rate by another 100 basis points, to 14% in March 2015, after reducing it by 200 basis points in January 2015, although as an oil-exporter the move is not linked to falling inflation but to lower perceived risk of previous capital outflow pressure.

Figure 1.3. Consumer price inflation in selected developing Asia-Pacific economies, 2014-2015

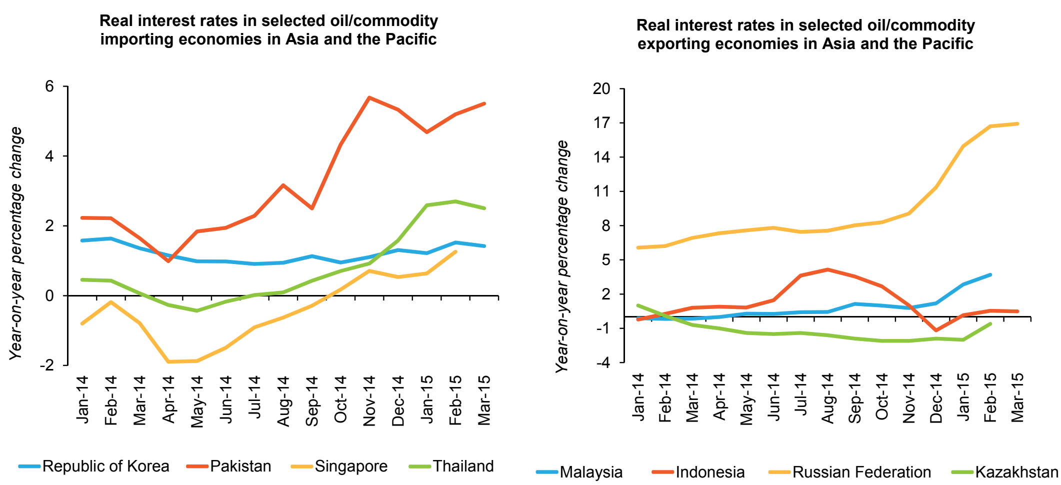


Source: ESCAP, based on data from CEIC Data. Available from www.ceicdata.com (accessed 30 March 2015).

Despite the relatively benign inflation outlook and reductions in nominal interest rates, it nevertheless remains the case that real interest rates in some economies remain fairly high (see figure 1.4) because of concerns regarding capital outflows and domestic debt, especially household debt. The economies particularly affected by the latter scenario are Malaysia, the Republic of Korea and Thailand. Lowering real rates would help borrowers in the short term and thus spur consumption; however, this could encourage exacerbation of debt accumulation in the longer term in the absence of targeted measures to reduce risky borrowing. In the case of China, consideration of lowering real interest rates runs counter to the ongoing policy of rebalancing away from investment. It could also increase financial market risks by increasing the possibility of overinvestment in areas which already have overcapacity and which may result in an increase in the number of non-performing loans, which could be damaging to financial stability.

In the area of fiscal policy, fuel subsidy savings have been used by some economies to strengthen their fiscal positions as well as improve the quality of their spending. **India** has pledged to cut its budget deficit to 3.9% in FY2014, while Indonesia intends to reduce the fiscal deficit to 1.9% in 2015

Figure 1.4. Real interest rates in selected developing Asia-Pacific economies, 2014-2015



Source: ESCAP, based on data from CEIC Data. Available from www.ceicdata.com (accessed 30 March 2015).

from an estimated 2.3% in 2014. At the same time Governments have improved the quality of their spending by redirecting spending from fuel subsidies to long-term development spending, especially on infrastructure, as well as on social programmes and targeted cash transfers. **Indonesia**, for example, plans to use part of the savings accumulated from virtual elimination of fuel subsidies in January 2015 to fund a doubling of capital expenditure as stated in the budget proposal for 2015. This spending will be particularly directed to finance much-needed infrastructure spending, which will help to increase the long-term potential growth of the economy. Indonesia has also embarked on an ambitious reform of social security supported by three new social security cards backed by a pre-activated mobile SIM card that enables the Government to transfer 200,000 rupiah ($16.50) to 15.5 million poor and homeless families. The money is to be collected at bank branches and post offices. **India** has also pledged to boost public infrastructure spending by using some of the savings from subsidies. The Government estimates that it may need up to $800 billion annually in infrastructure spending to reach a growth rate of 7%. For **Malaysia**, it is estimated that the removal of fuel subsidies will save 12 billion ringgit ($3.4 billion) in the budget.

Commodity-exporting economies, and most notably, oil producers have had to contend with strained fiscal positions in recent months. Those countries affected (in order of impact) include, among others, the Russian Federation and other North and Central Asian producers, the Islamic Republic of Iran, Malaysia and Australia. The impact has been harshest for the **Russian Federation**, with the Government estimating in January 2015 that the budget may have been in deficit in 2014 by 0.7%. This would represent the widest deficit for the Russian Federation since 2010. The Government of Malaysia revised budget projections for 2015 due to lower oil prices in January 2015, increasing the fiscal deficit target to 3.2% from 3%. While **Malaysia** will be significantly affected by lower oil prices, the impact will be less compared with some other oil-producing economies as Malaysia has substantially diversified its economy away from oil over recent decades. Energy exports currently account for 22% of total exports in Malaysia as compared, for example, with 70% for the Russian Federation.

In terms of tax policy reform, some Governments are taking measures to strengthen their public finances. **India** in December 2014 proposed to its parliament a goods and services tax, which is likely to simplify taxes while broadening the tax base. Some estimates state that this could bring in additional revenues of 2% of GDP stemming from more efficient allocation of resources with the removal of distortions from a multiple tax regime.[7] **Malaysia** also introduced a goods and service tax in April 2015 with more limited coverage as compared with the services tax and sales tax which it replaces. Such a measure will help the Government to reduce its fiscal deficit and public debt levels. The Government has encouragingly taken measures to reduce the immediate impact of the reform on consumers through a range of offsetting measures, such as exemptions, cash handouts to lower-income groups and reductions in income tax rates. **Indonesia** has pledged to increase tax receipts to 16% of GDP from the current 12% level, partly through improved procedures against tax evasion.

Some countries are also moving to address land acquisition procedures, which have been one of the key barriers to private sector investment in many cases. The Government of **India** in late-December 2014 issued an ordinance easing land acquisition regulations for infrastructure, industry and housing projects, with permanent confirmation pending by the legislature. **Indonesia** has promised to ease land acquisition to spur infrastructure projects, including buying land and establishing a land bank managed by different ministries. A single map is to be used by all provinces to prevent overlapping land concessions.

Some Governments have also been engaged in the process of reducing the role of State-owned enterprises, as well as increasing foreign business participation. By doing so, they are attempting to reduce the fiscal burden of such enterprises as well as increase their efficiency and thereby increase their contribution to growth and employment. **Viet Nam,** for example is engaged in an ambitious equitization programme, which serves as the first step in increasing the role of the private sector in State-owned enterprises. The programme involves converting such enterprises into public limited companies. In December 2014, the Government increased the number of State-owned enterprises to be equitized from 432 to 532. **India** in January 2015 sold shares worth $4 billion in its State-owned coal producer, and a number of State-owned banks have announced plans for a significant share sale in 2015. India in 2014 also increased its foreign direct investment limits from 26% to 49% for the defence and insurance sectors, as well as allowed 100% participation in railway infrastructure and most large construction projects.

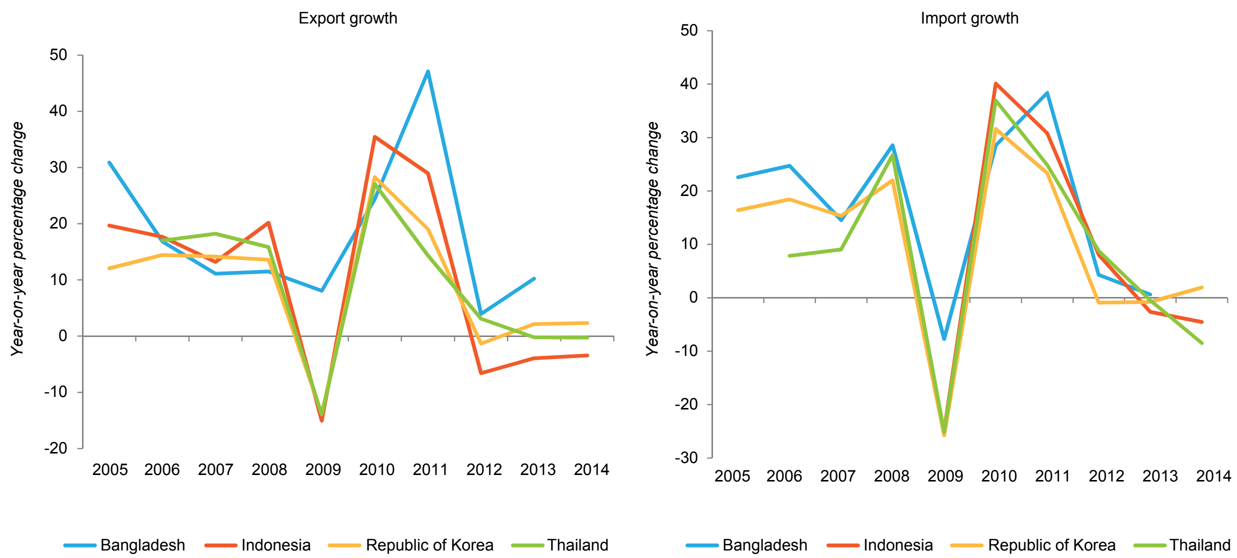
1.3. Trade prospects and foreign direct investment trends

Merchandise trade in Asia and the Pacific in 2015 continues to face significant challenges due to the regional as well as global macroeconomic outlook, as outlined previously in this chapter. Year-on-year export and import growth across developing Asia-Pacific economies has remained weak throughout 2014 (see figure 1.5). ESCAP estimates indicate that the export receipts of Asian and Pacific economies grew sluggishly, at a rate of 2.5% in 2014, while imports declined by 1.2%.

Given that China and eurozone economies are major export destinations for most economies in the Asia-Pacific region, with shares of 16% and 14% of total exports respectively, sluggish import demand in these economies remains a major risk to the export prospects of the region. The steady decline in oil prices since mid-2014 has had two opposing impacts on Asia-Pacific economies, depending upon the nature of their commodity trade position (commodity importing or commodity exporting).[8] Commodity-importing economies are benefiting from lower consumption and production costs, as the price of energy and primary inputs has declined. On the other hand, commodity-exporting economies are at risk of lower economic growth, currency depreciation, a decline in export revenues and a deterioration of current account positions. Owing to slower demand and the falling cost of production, the unit value of exports may also decline, which implies that the growth in export volume may recover somewhat. Nevertheless, export receipts of developing economies in Asia and the Pacific are expected to grow in the range of only 0-1% in 2015.

The region's services exports fared slightly better than merchandise exports, though the average growth in services exports declined from 7.4% in 2012 to 5.4% in 2013. The full-year data on trade in services for 2014 are not yet available, however, high-frequency monthly data indicate that the situation in Asia and the Pacific for services exports may have gone from bad to worse. China, in particular, has experienced a sharp decline in the export of services since mid-2014. In value terms, exports of commercial services by Asia-Pacific economies have reached $1.3 trillion, which accounts for 29% of the global exports of commercial services. These services comprise three broad categories: transportation; travel; and other commercial services,[9] with the other commercial services subsector accounting for more than 50% of total exports of commercial services by the region.

Figure 1.5. Annual growth of merchandise trade in selected Asia-Pacific economies, 2005-2014



Source: ESCAP, based on data from CEIC Data. Available from www.ceicdata.com (accessed 30 March 2015).

Services exports from Asia and the Pacific are not broad-based and have been driven by only a handful of economies. For instance, 65% of total exports of commercial services come from just six economies: China (15%); India (11%); Japan (11%); Hong Kong, China (10%); Singapore (9%); and the Republic of Korea (8%). Nevertheless, the region remains a net importer of commercial services, with import value of $1.4 trillion, which accounts for 32% of global imports.[10] Major importing countries are: China (24%); Japan (12%); and India, the Russian Federation, the Republic of Korea and Singapore (9% each).

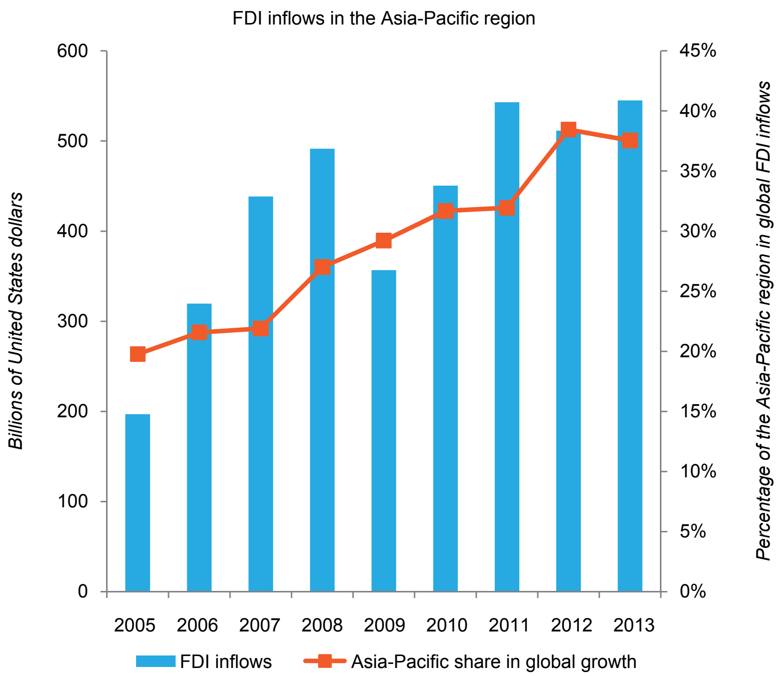
In terms of outlook, the export of services will be challenged by the weak demand within and outside the region as is the case with merchandise exports. In particular, the instability affecting the economy of the Russian Federation and the economic slowdown in China adds significantly to the negative outlook for services exports from the region, especially with regard to tourism.

The overall weak trade performance is despite the apparent progress in the multilateral trade negotiations at the level of the World Trade Organization after the Bali Ministerial Conference of December 2013. Nor did continued talks at the regional level within Asia-Pacific economies seem to have helped much to reinvigorate trade flows in the region (see box 1.1).

A positive development is that the Asia-Pacific region has remained a favourable destination for foreign direct investment (FDI) over the past few years. In 2014, developing Asia experienced a 15% increase in net FDI inflows[11] according to UNCTAD estimates.[12] In fact, the share of the Asia-Pacific region in global FDI flows (amounting to $545 billion) has been on the increase since 2005, reaching 38% of the global total in 2013 (see figure 1.6). The Asia-Pacific region has therefore demonstrated its resilience to challenges in the global economic climate characterized by relatively low and volatile global FDI flows since 2007.

Within Asia and the Pacific, FDI inflows have varied greatly among different subregions and countries as a result of: (a) different FDI policies adopted by countries; (b) the impact of regional economic blocs; (c) macroeconomic uncertainties and structural constraints; and (d) geopolitical tensions. For example, the South-East Asian subregion experienced undisrupted growth in FDI inflows during the period 2009-2013. The resilience of that subregion can be linked to the role that ASEAN is playing as a hub for many preferential trade agreements, which has helped in attracting steady FDI inflows into the region. The expected establishment of AEC at the end of 2015 could further enhance the attraction of

Figure 1.6. Share of Asia and the Pacific in global flows of foreign direct investment, 2005-2013



Box 1.1. Recent developments in multilateral trade negotiations and regional trade agreements

The Trade Facilitation Agreement (TFA), agreed at the ninth Ministerial Conference of the World Trade Organization (WTO) in December 2013, known as the Bali Package, is expected to be ratified by all members in 2015. The agreement is intended to simplify and enhance the transparency of trade procedures among countries. A study by the Organisation for Economic Co-operation and Development (OECD), based on a set of WTO-specific trade facilitation indicators and the ESCAP-World Bank trade cost database, suggested that implementation of the WTO TFA may help developing countries reduce trade costs by about 14% on average (Moïsé and Sorescu, 2013).

The Asia-Pacific least developed countries face additional challenges in securing global market access. In a high-level meeting of the WTO Services Council on 5 February 2015, members discussed measures which would support the growth of services trade in least developed countries by providing their services exports with preferential treatment. This would be an important step in implementing a key Bali decision in support of least developed countries, which is aimed at enhancing their participation in the global services trade.

Recent years have seen a proliferation in preferential trade agreements. Currently, regional attention is focused in particular on the ongoing negotiation of two "mega-regional" deals, namely the proposed trans-Pacific partnership (TPP) and regional comprehensive economic partnership (RCEP) (ESCAP, 2014a). TPP now includes 12 Asia-Pacific Economic Cooperation (APEC) economies (including two ASEAN member States, namely Malaysia and Viet Nam), with the possible inclusion of others in the future. In contrast, RCEP is limited to the 10 ASEAN member States and their 6 dialogue partners (known as ASEAN+6) with which the 10 ASEAN members have already signed various free trade agreements. There is greater initial scope for liberalization among the RCEP economies as existing tariffs and restrictions on services trade and investment are higher than among the TPP members. However, TPP is likely to lead to deeper integration and include more substantive agreements on issues beyond and outside current WTO obligations in several areas including: (a) labour and environmental standards; (b) intellectual property rights; (c) government procurement; and (d) investment and competition policy.

In addition, the recent meeting of APEC leaders in Beijing in November 2014 has spurred renewed interest in the idea of a broader free trade area of Asia and the Pacific (FTAAP) building on TPP and RCEP. The declaration issued at the end of the summit reaffirmed the commitment of the leaders to "the eventual FTAAP as a major instrument to further APEC's regional integration agenda". Towards this end, leaders launched the Beijing Roadmap for APEC's Contribution to the Realization of the Free Trade Area of Asia-Pacific, which set out a number of actions to be taken (APEC, 2014). The benefits from an ambitious FTAAP could be substantial in view of the enormous economic size of the group: 58% of the global GDP (see table A). The economic benefit that FTAAP could achieve would, however, depend on the level of liberalization, the final number of members and whether FTAAP could trigger consolidation of complex and overlapping existing regional arrangements responsible for the "noodle bowl" effect, which is having adverse impacts on the business environment for traders.

Table A. Economic size of the proposed trans-Pacific partnership, regional comprehensive economic partnership and free trade area of Asia and the Pacific

	TPP	RCEP	FTAAP
Number of economies involved	12	16	21
Population (millions)	802	3 430	2 783
Aggregate share of world GDP (percentage)	38	29	58
Aggregate share of world exports (percentage)	24	30	46
Number of bilateral agreements among the negotiating parties already in implementation	25	23	51

Source: Schott (2014) and ESCAP calculations based on APEC statistics.

the subregion for FDI flows (see box 1.2). Another example is China where the Government adopted a strategy of "going global".[13] With continuous efforts, FDI inflows into China have been increasing since 2008 despite temporary small dips, and that country became the largest FDI recipient in the world in 2014 with inflows of $120 billion.

In contrast, geopolitical tensions and foreign sanctions prevented the Russian Federation from attracting prospective investors, despite the fact that the business environment had apparently improved over the past few years.[14] The country managed to attract an estimated $19 billion in FDI inflows in 2014, a decline of 70% compared with the exceptional level reached in 2013.[15] In India, FDI inflows have been volatile since 2008; in 2014, FDI inflows increased by 26% to reach $35 billion, which still remains far below the peak of $47 billion that it recorded in 2008.

In addition to being recipients of investment, many economies in the Asia-Pacific region have increased their capacity as investors as well. FDI outflows from the region have increased since 2009, and in 2013, the value of such was $526 billion, a 15% increase compared with that of the previous year. China has recorded steady growth in FDI outflows since 2004, almost doubling its overseas investments in the past decade; it recorded more than $100 billion in FDI outflows in 2013. Japan is the largest investor in the region, even as it is recovering from the ongoing crisis; it recorded $136 billion in overall FDI outflows in 2013. The Republic of Korea and Singapore also have continued to increase their outward investments, reaching $27 billion and $29 billion in 2013, respectively. Some smaller economies, such as Cambodia and Viet Nam, are also steadily increasing their outward investments.

In terms of categories of FDI, there has been a shift in the respective roles played by greenfield FDI and mergers and acquisitions (M and A). Traditionally, greenfield FDI has been a significant mode of entry for FDI into the Asia-Pacific region, with more than 3.6 trillion having been invested through this mode

Box 1.2. ASEAN Economic Community in 2015: achievements and remaining challenges

In December 2015, the Association of Southeast Asian Nations (ASEAN) will reach its self-imposed deadline for realizing the ASEAN Economic Community (AEC). However, the deadline is best viewed as one milestone on the longer road towards deeper integration, and many challenges will persist beyond 2015. Thus far, progress has been mixed across the four pillars of the AEC Blueprint, which call for the transformation of ASEAN into:

- A single market and production base;
- A highly competitive economic region;
- A region of equitable economic development;
- A region that is fully integrated into the global economy by the end of 2015.

Although the AEC Scorecard, a self-assessment mechanism, suggested that ASEAN is on track and had reached more than 82% of its final targets by early 2015,[a] challenges remain at the implementation level of each pillar.

With respect to the first pillar, a single market and production base, the greatest success has been in the removal of tariffs: zero tariff rates for intra-ASEAN trade have been applied to 99% of tariff lines in six ASEAN countries (namely, Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand) since 2010, and to 72.6% of tariff lines in the so-called CLMV countries (Cambodia, the Lao People's Democratic Republic, Myanmar and Viet Nam) since 2013. However, non-tariff barriers have emerged as a serious trade impediment. Progress towards their elimination (intended by 2010 for most countries) has been slow and the development of a shared ASEAN database has lagged. Investment liberalization has also been limited by the identification of sensitive sectors by ASEAN countries, especially Indonesia, Thailand and Viet Nam, which will be exempted from liberalization commitments. Some progress in trade facilitation has been made though the ASEAN single window programme is behind schedule as countries are still struggling to introduce national single windows which are a necessary precursor.

The most highly problematic area in the first pillar is the enforcement of the agreements related to liberalization of trade in services and the mobility of skilled labour. In general, trade in services remains less liberalized than trade in goods. Although ASEAN ministers declared 2015 as the end-date for liberalization of all service sectors, implementation of agreements is still an issue as, in practice, domestic restrictions on equity landholdings and licensing requirements continue to pose significant barriers to intraregional investment in services and mobility of skilled labour.

The second AEC pillar is aimed at establishing a highly competitive economic region and covers: competition policy; consumer protection; intellectual property rights; infrastructure development; taxation; and e-commerce. While various framework agreements in these areas have been adopted the necessary domestic legislation has yet to be enacted.

Box 1.2. *(continued)*

The Initiative for ASEAN Integration is targeted at narrowing the development gap between six ASEAN members and the CLMV countries, under the third pillar. The CLMV countries have been provided with technical assistance and capacity-building programmes under the Initiative for ASEAN Integration. However, substantial gaps remain, and realizing equitable economic development within and between countries will require strong commitment and long-term efforts in economic restructuring, making policy and regulatory reforms, and building human capital.

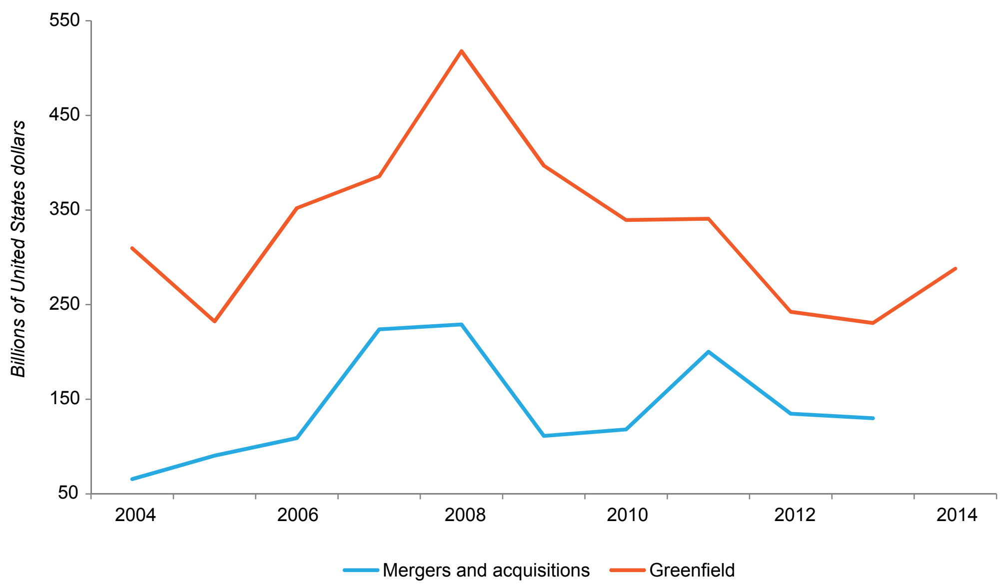
ASEAN has had some success in integrating into the global economy under the AECs fourth pillar; many members are deeply enmeshed in global supply chains. The initiation of negotiations on the Regional Comprehensive Economic Partnership (RCEP) in 2012 with the six partners, namely Australia, China, India, Japan, New Zealand and the Republic of Korea, is a good opportunity to reinforce ASEAN centrality in its external economic relations if it is used to streamline and harmonize provisions in the existing network of ASEAN-plus FTAs.

[a] Based on the AEC Scorecard, the region achieved 82.1% of its targets at the end of 2014. See Das (2015).

since 2004. However, the growth of greenfield FDI has declined notably since 2008, and greenfield FDI inflows still have not reached their pre-crisis level of $518 billion in 2008. In 2014, greenfield FDI inflows into the region amounted to only $288 billion. In contrast, FDI through M and A has recently gained in importance. M and A activities doubled from $66 billion in 2004 to $130 billion in 2013, although they stagnated in 2013 (see figure 1.7). At the global level, cross-border M and As are also on the rise, having recorded a 19% increase in 2014.

As with the total greenfield FDI flows of the region, the growth of intraregional greenfield FDI in Asia and the Pacific has also declined since 2008 when it reached its peak at $184 billion. It still has not attained the pre-crisis level, despite an increase of 60% in 2014, when it reached $133 billion. Nevertheless, intraregional greenfield FDI has retained its significance in the Asia-Pacific region. Specifically, the share of intraregional greenfield FDI flows in total greenfield FDI flows in the region has increased to 46% in 2014, up from 35% in 2006.

Figure 1.7. Greenfield foreign direct investment and mergers and acquisitions in the Asia-Pacific region, 2004-2014



Source: ESCAP, based on data from CEIC Data. Available from www.ceicdata.com (accessed 30 March 2015).

It is also noteworthy that, while intraregional greenfield FDI flows to such destinations as China, Indonesia and Viet Nam are still popular, these countries have recently received less investment, whereas smaller economies, such as Myanmar and Pakistan, have received more – resulting in somewhat diversified destinations of intraregional investment.

Moreover, intraregional greenfield FDI has become more diversified in a broader range of industries. During the period 2012-2014, investments in natural resource-heavy industries, such as coal, oil, natural gas and metals, decreased; however, they increased or remained stable in knowledge-based industries and services, such as communications and financial services, compared with the period 2006-2011.

On the other hand, intraregional M and A accounted for 40% of total FDI inflows through M and A in the Asia-Pacific region during the period 2011-2013. Intraregional investors are increasingly replacing investors from Europe and the United States. High-growth economies especially are receiving large shares of intraregional FDI inflows, such as China; Hong Kong, China; and the Republic of Korea, which received 72%, 66%, and 45%, respectively, of FDI inflows through intraregional M and A activities during the period 2011-2013. China was the largest contributor to intraregional M and A activity in the Asia-Pacific region during the period 2011-2013 with the conclusion of deals valued at close to $35 billion.

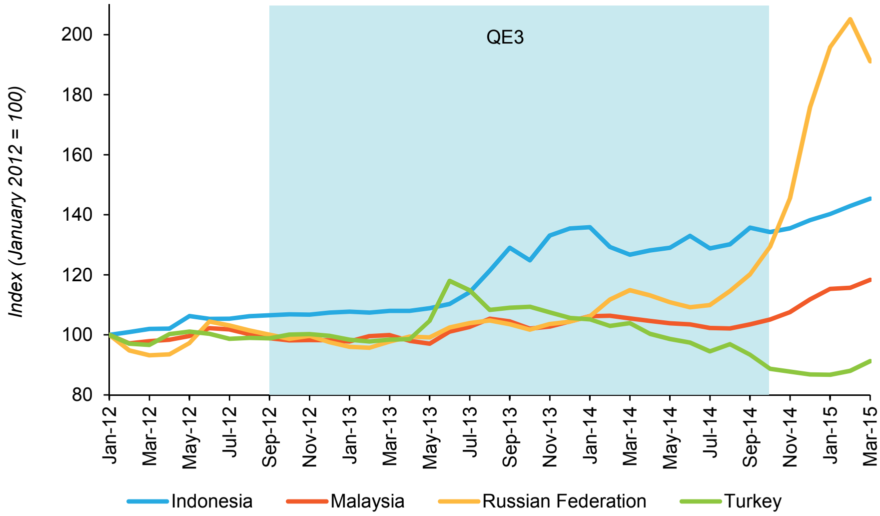
1.4. External sector, exchange rates and financial markets

Expectations about monetary policy normalization of the United States of America, a likely increase in interest rates to be specific, have led capital to flow from other countries to the United States of America. As a result, the dollar has increased in value substantially against currencies in the region as well as globally. In global terms, the index of the dollar versus six major currencies reached an 11.5-year high in March 2015. While exchange rates in the Asia-Pacific region have been affected by the strength of the dollar, there has been considerable divergence in performance between economies. Some currencies in the region have declined only slightly against the dollar whereas others have seen more significant decreases (see figure 1.8). The economies in the region which have seen most significant depreciation have been those with some concerns about macroeconomic fundamentals, such as high current account or budget deficits. For example, in March 2015 Indonesia's currency fell to its lowest level since 1998, while that of Turkey also fell to historic lows. Even many of the currencies of developing economies with the greatest depreciation since June 2014 have declined slightly less than the global trade-weighted average of about 12%. These include such economies as India, Indonesia, Pakistan, the Republic of Korea and Singapore. On the other hand, currencies of some other economies have declined far less compared with the global average, including those of the Philippines, Sri Lanka, Thailand and Viet Nam.

A number of factors explain the relatively small depreciation in some currencies in the region. One is foreign exchange intervention by Governments driven by concerns about: (i) imported inflation stemming from depreciation; and (ii) increased foreign debt repayment costs. While Malaysia and the Russian Federation utilized a large amount of reserves since mid-2014, others such as Thailand and Turkey depleted their reserves to a lesser extent (see figure 1.9). Another reason for the relatively small decline in the value of currencies in some economies in the region is continuing institutional investor interest in financial assets of the region due to better growth prospects in comparative global terms. This partly explains the fairly stable values, for example, of the currencies of China and Sri Lanka.

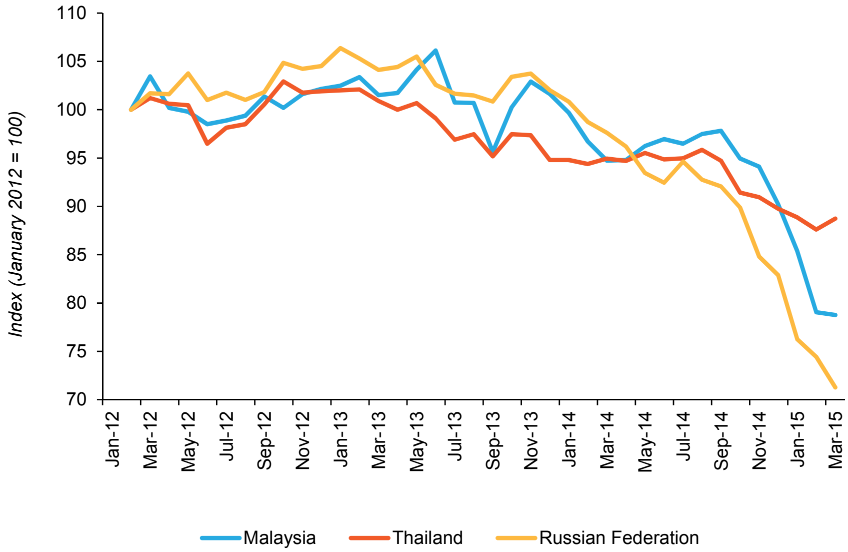
As currencies of the region have generally depreciated less than the global trade-weighted average, they may not obtain the significant trade gains that otherwise would be possible. This is most evident when comparing the steep declines against the dollar of the currencies of major exporting nations, such as Japan and countries in the eurozone, which have experienced depreciations of 20% and 28%, respectively, against the dollar. The increased export competition from these countries means that economies in the Asia-Pacific region are unlikely to experience as substantial an export benefit as might otherwise have been possible due to their depreciating currencies. Particularly important is the relatively small decline in the currency of China compared with those of those developed economies. Since mid-June 2014, the currency of China has remained nearly unchanged in value against the dollar. This decline in relative exchange rate competitiveness could negatively

Figure 1.8. Exchange rate indices in selected Asia-Pacific economies, 2012-2015



Source: ESCAP, based on data from CEIC Data. Available from www.ceicdata.com (accessed 30 March 2015).

Figure 1.9. Foreign reserves in selected Asia-Pacific economies, 2012-2015



Source: ESCAP, based on data from CEIC Data. Available from www.ceicdata.com (accessed 30 March 2015).

affect both the exports of China and the exports of the region through the important channel of Asia-Pacific production networks feeding final exports from China.

Analyzing further, it can be observed that oil-importing countries are experiencing two contrasting impacts on their exchange rates. Owing to the decline in international oil prices and thus the import bill, the current account balance has been positively affected, leading to an appreciation pressure on the exchange rate. However, there is also depreciation pressure in some countries due to capital outflows stemming from global risk aversion. Previous experience indicates that the economies most affected by general risk aversion are those with weaker macroeconomic fundamentals, such as high inflation and large budget and current account deficits.

Oil-exporting economies and economies linked to them, on the other hand, are experiencing a significant double negative impact on their exchange rates – from decreasing oil exports and increasing portfolio capital outflows in response to the economies' worsening macroeconomic fundamentals. The combined impact is already visible, for example, in the case of the Russian ruble, which experienced a 40% depreciation against the dollar in 2014. Furthermore, economies in North and Central Asia, which are tied through trade and remittances to the Russian Federation, have experienced similar pressures on their currencies. Some of these economies have let their currencies depreciate while others have spent large sums of foreign exchange reserves in defending their currencies. There were depreciations of 16%, 10% and 9% in the currencies of Kyrgyzstan, Tajikistan and Uzbekistan, respectively, in 2014.

An important policy consideration is that the increasing financialization of commodities in recent years implies that the financial sector is deeply affected by volatility in the commodity markets. There is potential for significant losses or gains to be made by the banking and investment community depending on whether they have taken the correct positions on commodity price movements. One important area of exposure of investment banks is in commodity credit derivatives. Losses in this segment of the financial markets can become contagious because of the interrelationships between different asset classes and the counterparties that trade in them. Increased volatility in commodity credit derivatives can cause losses, for example, in interest rate derivatives and foreign exchange assets. The conventional wisdom at the moment is that the risk stemming from commodity-related financial assets is not on par with that of subprime mortgages. However, it is worth highlighting that every financial crisis has risked underestimating the depth of financial market interlinkages with the rest of the economy. The implication for credit markets of any large losses suffered by the banking industry – stemming from commodity-related assets – would be the need to make credit scarcer. If banks were to lose assets through the investment-banking portion of their business, they would have to attempt to recover them through appropriating assets from the commercial and retail side of their business. This would necessarily reduce the availability of credit in the real economy and therefore could have a negative impact on growth. These kinds of dynamics were at play during the 2008 financial crisis as well.

Some economies in the region have attempted to manage the negative impact of capital outflows on their asset markets through macroprudential measures. Apart from the impact on exchange rates, capital outflows have the potential to undermine macroeconomic stability and household wealth by their impact on domestic asset markets. Some of the key asset markets in relatively open economies which have seen significant foreign capital inflows are the equity, bond and property markets. Outflows from these markets can destabilize the banking sector as domestic banks may suffer losses on their investments in these markets, while they also have negative impacts on household wealth and therefore consumption because households will experience declining values for their investments in such markets. Some economies have attempted to manage the scale of capital outflows from such markets by imposing or increasing macroprudential regulations in these areas. A number of economies across the region, such as Hong Kong, China; and Singapore, have adopted measures, such as increased deposit requirements for mortgages and higher stamp duties, to deal with speculative property purchases. For example, in February 2015, Hong Kong, China mandated a 15% mortgage regulatory risk weight for banks, which is intended to lower banks' regulatory capital ratios and temper growth in mortgage lending. A number of countries have also adopted measures to encourage long-term entry of portfolio capital, such as through unremunerated reserve requirements on non-resident deposits, withholding taxes, or restrictions on non-resident holdings of domestic assets.

2. RISKS AND CHALLENGES

2.1 Domestic structural concerns

2.1.1. Infrastructure deficiencies

Infrastructure needs in the region are phenomenal, with shortages in transportation, energy, water and sanitation. The order of magnitude estimates by ESCAP indicate that the region's total infrastructure investment requirements would be around $800-900 billion per year. Better infrastructure is required to increase the supply potential of economies by increasing productivity and therefore the growth potential in a region where demand continues to remain substantial as a result of growing populations and rising incomes. Furthermore, the region's significant role in global trade and global production networks means that improved infrastructure will also enable economies to better service global demand. One estimate suggests that every $1 invested on infrastructure development can yield additional increases in GDP of $0.05-$0.25, which implies increasing GDP growth by 5% to 25% (World Economic Forum and PricewaterhouseCoopers, 2012). Improving infrastructure will also enable economic growth to be more inclusive by allowing the fruits of development to reach more people, especially those in rural areas and the poorer sections of the society in urban areas.

Increasing urbanization throughout the region is creating additional demands for infrastructure. One estimate puts the need for infrastructure in Asia and the Pacific resulting purely from urbanization at more than $11 trillion over 15 years (HSBC, 2013). Urbanization is expected to grow in line with rising wealth in the region, as higher-income economies typically have higher levels of urbanization; high-income economies in the region have urbanization rates of 90% as opposed to 30% in low-income economies. In 2012, 46% of the population of the region lived in urban areas, which under current growth rates is expected to increase to 50% by 2020. This would translate into an additional 500 million people living in urban areas (Fidelity Worldwide Investments, 2014). The region's share of the world's urban population is projected to grow from 42% to 63% between 2010 and 2050 (UN-HABITAT and ESCAP, 2010). Some of the effects will be increased demand for utilities and for housing. There will also be a greater need for public transport to reduce the burden of congestion due to private vehicles.

In meeting the diverse but related challenges posed by urbanization, it is logical for infrastructure deficits to be tackled in an integrated way, which supports both sustainable and inclusive urban growth, but also ensures that the economic potential of the region's cities is realized. As the Asia-Pacific region and most notably South and South-West Asia will continue to urbanize for decades to come, action must be taken which will result in closing infrastructure gaps in ways that contribute to low-carbon and liveable cities. Low-carbon and inclusive infrastructure can be designed to tackle both local and future challenges of sustainability and equity. Rethinking housing, sanitation and transport infrastructure in such a light would have significant impacts on shaping the cities of the future and moving away from "cities as usual". This includes affordable solutions in which needs are matched with low-technology and low-carbon solutions. Similarly, supporting green industries through fiscal and other policy tools towards innovation across infrastructure sectors will provide a key opportunity in support of these goals.

In considering particular infrastructure requirements of the subregions, the greatest infrastructure need in monetary terms lies in improving electricity generation, especially in **South and South-West Asian** economies. One measure of the requirement in power generation for the subregion is about $400 billion annually (ADB and ADBI, 2009). Access to electricity in South Asia is significantly lower, at 71% of the population, as compared with, for example, 92% of the population in East and North-East Asia. Other major requirements lie in the area of road construction and, despite the dramatic spread of mobile telephony, telecommunications infrastructure also remains far behind demand.

A recent report puts the total needs for the subregion at $2.5 trillion over the next 10 years (Andrés, Biller and Dappe, 2014b). Of this total, one third is for energy-related projects and one third for transport projects, with the remainder being for water supply and sanitation, solid waste management, telecommunications and irrigation. While the financial cost of providing water and sanitation is somewhat less than that of energy and transport infrastructure, the situation in the region in these areas is more extreme and akin in some measures to the situation in sub-Saharan Africa. Currently, 41% of the population does not have access to toilets and 75% do not have access to piped water. Greater investment in infrastructure in South and South-West Asia will require improving the investment climate in terms of simplifying regulatory and tax structures and amending labour and land acquisition laws while ensuring that environmental and social concerns are addressed.

In **South-East Asian** economies, the needs lie most in the transport, energy and communications areas. It has recently been estimated that the cumulative needs for South-East Asia are $950 billion up to 2020, with the region currently investing only half the resulting yearly requirement.[16] Within energy generation only, it is estimated that South-East Asia would need to increase its power generation by 76% by 2030 to meet growing demand. Urbanization is also a particular challenge for the subregion, with the urban population in the ASEAN economies expected to double by 2020. It is notable that infrastructure investment has been lacking in the region ever since the 1997 Asian financial crisis, having fallen for five major South-East Asian economies, namely Indonesia, Malaysia, the Philippines, Thailand and Viet Nam, to $25 billion in 2010 compared with $38 billion in 1997.

It has been posited that low investment rates can be explained to some degree by Governments' attempts to maintain current account surpluses and build up foreign exchange reserves in order to prevent suffering from a rerun of the 1997 Asian financial crisis. The outcome has been that government reserves have been invested in short-term developed economy bonds as a safety measure to counter any capital outflows rather than being directed to domestic investment projects, such as in infrastructure development. Capitalizing on the ASEAN Economic Community, which is being established at the end of 2015, crucially will require significant investment in infrastructure. Without this, ASEAN runs the risk of falling into a middle-income trap, with growth on a declining trend as economies are not equipped with the resources to take advantage of higher value-added industries linked through global and regional production networks.

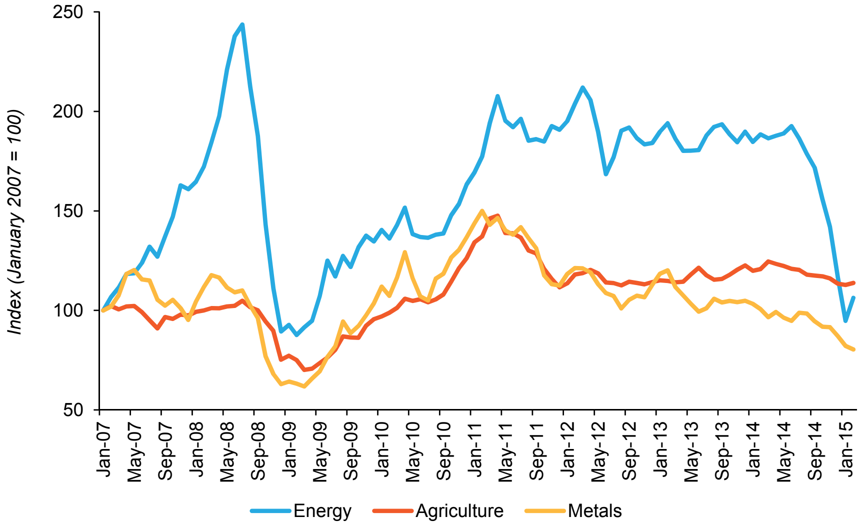
Furthermore, integration in **North and Central Asia** is being delayed due to the lack of transport infrastructure. In addition, greater integration is also required of transport and logistics networks, which would save time at border crossings and shorten transportation routes. There would then be scope for the subregion to serve as a land bridge between East Asian producers and consumers in the European Union. There have been various subregional initiatives on these lines, such as the Eurasian Economic Union[17] and the Shanghai Cooperation Organisation,[18] among a number of others, as well as the bilateral "Silk Road" initiative[19] of China involving various North and Central Asian countries. However, the challenge will be to ensure efficiency between the initiatives of the various groupings and avoidance of a "noodle bowl" effect,[20] which would increase complexity and the demands on Governments.

2.1.2 Commodity-dependence

Commodity price swings are nothing new, but the recent sharp drop in the Brent crude oil price has caught many economic managers in the region by surprise. Coal prices have also declined in recent quarters, affecting major exporters, such as Australia and Indonesia. Natural gas prices are also likely to fall as they tend to track oil prices with some lag. Industrial metals, such as copper, iron ore and nickel, have also witnessed downward volatility, as is the case with food and agricultural raw materials, such as palm oil and rubber (see figure 1.10). While various demand and supply factors are at play, some commentators believe that the recent decline in commodity prices may signal the end of a "commodity super cycle" after more than a decade of a commodity boom, which was only briefly interrupted by the global financial crisis.[21] In the near term, however, uncertainty exists about the size and direction of the spillover from oil prices to other commodity prices and about the reallocation of production prompted by price changes.[22]

Although the majority of economies in the Asia-Pacific region are net commodity importers, which will benefit from the recent trend, the region is also home to more than a dozen countries for whom commodity exports account for a significant share of their GDP (see table 1.2). This latter group, which includes a wide range of countries with different income levels and population sizes, is expected to feel the impact of lower commodity prices on multiple fronts, including output and employment, external and fiscal balance, and price and financial stability largely via the exchange rate channel.[23] The severity of the impact, however, will

Figure 1.10. Commodity price indices for energy, agriculture and metals, 2007-2015



Source: ESCAP, based on data from CEIC Data. Available from www.ceicdata.com (accessed 30 March 2015).

depend on, among other things, the availability of countercyclical tools and measures in the short term and the diversified structure of the economy in the longer run.

Commodity exporters, such as Azerbaijan, Kazakhstan, Mongolia and the Russian Federation, could see a real GDP growth slowdown of more than four percentage points between 2013 and 2015. Less commodity-intensive economies are also expected to be negatively affected by lower commodity prices. For instance, Malaysia has slashed its official GDP growth forecast for 2015 by a full percentage point. Similarly, Australia also is also expected to experience relatively sluggish growth. As a short-term response, countercyclical measures are being introduced. For instance, Azerbaijan lowered the reserve requirement for banks while Kazakhstan announced a three-year stimulus package with a focus on housing, utilities and transport infrastructure. The Russian Federation also introduced several measures, such as the establishment of a loan guarantee agency to support SMEs, although most are in direct response to international sanctions rather than the oil price decline. Some of the impact on domestic output will be felt more gradually as investment in the energy exploration and production sector and rural farm incomes are adversely affected.

While the impact on employment is more difficult to assess, the higher employment intensity of certain commodities, such as palm oil and rubber compared with oil and gas, implies that countries specializing in the former commodity group will be more heavily affected. This includes Indonesia, Malaysia and Thailand and cotton producers, such as Tajikistan. Pacific island countries, such as Fiji, may also fall under this category, although their heavy reliance on food and fuel imports suggests some offsetting effects.

Table 1.2. Countries where commodity export-to-GDP ratio exceeded 10% in 2000-2013

30% plus	Azerbaijan (-3.5), Brunei Darussalam (3.3), Islamic Republic of Iran (2.8), Kazakhstan (-4.5), Mongolia (-8.2), Myanmar (0), Papua New Guinea (9.9), Timor-Leste (1.1) and Turkmenistan (-0.7)
10-30%	Australia (-0.1), Bhutan (2.6), Indonesia (-0.2), Malaysia (0.2), the Russian Federation (-5.3) and Viet Nam (0.7)

Source: ESCAP, based on World Development Indicators.

Note: Figures in parentheses show the percentage point difference between real GDP growth in 2013 and the 2015 forecast. Estimated figures are used for the Islamic Republic of Iran and Myanmar. For Timor-Leste, the parentheses show non-oil GDP, as the economy as a whole has been contracting in recent years from declining oil production. Countries, the ratios of which exceeded 10% mainly due to food commodities, are excluded, such as Thailand and several countries in the Pacific.

Moreover, several commodity exporters may see their current account balances deteriorate due to the negative terms of trade shock. This was already spotted last year in such countries as Azerbaijan and Timor-Leste, although the drop in their production volumes was also a prominent factor. Often, the aggregate change in the current account balance will be mitigated by a drop in capital imports as investment slows in these economies, as in the case of Mongolia. There could also be some positive offsetting effect if weak commodity exports result in the depreciation of the local currency thereby making manufacturing exports more competitive. Importantly, as in the case of Indonesia, a deteriorating current account balance may necessitate monetary tightening in the light of the uncertain external financing environment and therefore could further dampen the domestic economy.

Government budgets are also feeling the impact of high commodity-dependence. For instance, the Russian Federation announced a 10% cut across most parts of its budget, even as it draws down its national welfare fund to mitigate some impact. The Government of Malaysia plans to slash spending by some $1.5 billion in 2015, or about 2% of its proposed outlays; oil and gas royalties and taxes account for some 30% of the country's revenues. A number of countries had to revise their 2015 budgets, which were based on oil prices of $100 or more per barrel. This could have a severe impact on such economies as Timor-Leste where government spending dominates the non-oil economy and private sector development is at a nascent stage. Some countries may also face a higher public debt-to-GDP ratio, or at least slower pace of reduction compared with the commodity boom period.

Price and financial stability are also being affected, primarily through the exchange rate channel. The Russian Federation is expecting double digit inflation this year, although again, this may be due to international sanctions more than other reasons. In fact, other commodity-export economies in North and Central Asia are not foreseeing significant acceleration in inflation. More countries may be vulnerable to financial instability. Studies show that many commodity exporters tend to experience a banking crisis during sharp declines in commodity prices.[24] While this is an extreme case, even countries such as Malaysia are feeling some pressure as the ringgit depreciates; its total external liabilities stand at about 70% of GDP, and companies are spending less on investment as servicing costs in dollar terms climb higher.

In the longer term, commodity-dependence can affect the process of structural change in economies. Economies develop through structural change, in which labour migrates from low- to high-productivity sectors (McMillan and Rodrik, 2011). Often, the output share of agriculture declines while that of manufacturing and related services rises as economies develop. Employment follows a similar pattern, although agriculture and services tend to retain or absorb more labour compared with manufacturing. Even within sectors, labour could migrate to higher productivity subsectors. Diversification could thus occur in various ways, including moving into new products and services (horizontal diversification), through backward and forward linkages of existing products and services (vertical diversification), quality upgrades and market expansion.

Resource-rich economies tend to undergo less economic diversification even as aggregate output and income rises. The literature on the "Dutch disease" and the international experience in past decades, for instance, of slower productivity gains in resource-rich economies in Africa and Latin America compared with non-resource-rich newly industrialized economies in East Asia point to a number of potential reasons for such developments (Sachs and Warner, 2001). For instance, real appreciation in the currency could shift labour, capital and land from non-commodity traded goods to commodity traded goods and non-traded goods and services. Often the manufacturing sector is crowded out. This is particularly harmful as the manufacturing sector has externalities for long-run growth from learning by doing, the scope for which is far more limited in the agricultural and mining sectors (Gylfason, Herbertsson and Zoega, 1999). Moreover, crowding out of manufacturing could further limit the scope for diversification, given that diversification tends to be "path-dependent", that is, the existing product mix of a country tends to affect the potential new products that could emerge (Freire, 2011). This phenomenon seems to have also happened in the Asia-Pacific region. Between 1995 and 2013, only a few commodity exporters, including Nepal, Samoa, Uzbekistan and Viet Nam, succeeded in diversifying their export base while many others, including Australia, Azerbaijan, Kazakhstan, the Russian Federation and Tuvalu, went in the opposite direction of further concentrating their export profile.

At least in principle, commodity dependence may not pose a problem as long as supplies last and prices remain high. Even economies with abundant reserves, such as Kazakhstan, however, face some uncertainty in supplies, while others, such as Timor-Leste, are expected to deplete all their oil reserves within a decade. As was seen in the recent downward volatility, prices do not always remain high. Decades of a downward trend were reversed in the 2000s, but the recent drop in oil prices may signal the end of a commodity "super cycle". Of course, the global economy keeps on expanding and energy demand is expected to grow rapidly in developing economies, but it should also be noted that the commodity intensity of the global economy keeps on declining as well. Given numerous possible scenarios, commodity exporters should not consider themselves as an exception to the rule that economic development requires structural change.

Importantly, lack of diversification among commodity exporters is often associated with weak governance and business environment. This is possible because of excessive rent-seeking activities. Human capital also tends to suffer, as primary sectors, such as mining, cannot absorb much labour compared with manufacturing. These deficits could hamper economic development, particularly in the private sector. Nonetheless, it is also a concern because resource-driven economies would require a large public sector in order to distribute the wealth equitably across the population. However, if there is much corruption and weak capacity in the Government, welfare gains would be neither widely nor efficiently realized. Among commodity exporters, such countries as Australia, Chile, Malaysia, Norway and Viet Nam score high or have improved their indicators on governance and doing business. Interestingly, these economies also tend to exhibit more progress in economic diversification.

2.2. External challenges

2.2.1. Capital flow volatility

An important economic challenge for the region in 2015, emanating from outside, will be managing the likely financial market volatility resulting from monetary policies of the major global economies. The region is contending with the ongoing monetary policy normalization of the United States. With steady growth in the economy over recent quarters, the Federal Reserve Bank of the United States is now expected to raise the interest rate from its current level of close to zero after having first removed quantitative easing over the course of 2014.

A key new development is the announcement of quantitative easing by the eurozone in January 2015. In addition, Japan has been engaged in a quantitative easing programme under what has been called "Abenomics" since late 2011 in an attempt to escape deflationary pressures and spur growth in the economy. When considered in total, new liquidity from the eurozone and Japan exceeds what was produced by the United States at the peak of its programme. Thus, fresh liquidity from Japan and the eurozone has the potential to buffer the financial markets in the region from the absence of fresh liquidity from the United States. The question is whether these sources of fresh funds are likely to come to the region in the same quantity as those from the United States did in the past.

One likely reason why there may be net pressure for capital to flow out from the region is the narrowing differential in potential returns between financial assets in the region and those in the United States. Capital market outflows from the region to the United States would be encouraged by the foreseen likely increase in United States interest rates and better growth in the United States economy. These phenomena would imply that the gap between United States interest rates and growth and Asia-Pacific interest rates and growth would have decreased. This is especially true at a time when growth and therefore the interest rate prospects of the region are less rosy than in the past, at least in relative terms. The argument of growing differentials with the United States along with its implications applies to assets of the eurozone and Japan as well. In those countries, growth and interest rate prospects are worse than for Asia and the Pacific as a whole. Therefore, fresh liquidity from the eurozone and Japan may not flow into the region in as large quantities as had been the case when liquidity was being produced in the United States a few years ago; the liquidity may flow instead to the United States.

Increasing global risk aversion is another reason why funds leaving the eurozone and Japan may not come to Asia and the Pacific, and funds already in the region may exit instead. There is a strong perception among many investors of a global climate of continued weak economic growth and macroeconomic instability for a number of reasons. Such perceptions tend to lead to a “flight to quality”, which is mainly to the United States dollar as well as the yen. One reason for such preferences is the slow economic growth in the eurozone and Japan, as well as slowing economic growth in China, which is dragging down global economic growth as a whole, given the weight of these markets in global GDP. Another reason is the fear that low oil prices could lead to deflation in major developed economies, which may have a negative impact on economic growth in addition to increasing the likelihood of lower interest rates.

Capital outflows are of concern because they have an impact on macroeconomic stability through a variety of mechanisms. Economies that have high foreign debt commitments, in both government and corporate sectors, tend to be more vulnerable. A number of countries in the region have significant foreign repayment commitments, the value of which would rise in local currency terms if there is currency depreciation as a result of capital outflows. Countries with relatively high external debt commitments in the region include Malaysia at more than 60% of GDP, Turkey at nearly 50% of GDP and the Republic of Korea at nearly 30% of GDP. Household debt is an added concern in some economies, with some banks financing high domestic lending by borrowing from abroad. They are, therefore, prone to the risk of an increase in their borrowing costs, which would then be passed on in terms of higher interest rates for domestic borrowers. Malaysia and Thailand have the highest household debt in the region, with levels approaching 90% of GDP. Another impact of capital outflows would be directly on domestic asset markets in which capital inflows have been prominent. These include equity, bond and property markets in a range of economies. For example, Hong Kong, China; and Singapore are among the economies with particularly strong property sectors influenced by capital inflows. Any resulting sharp decline in asset values would adversely affect the wealth and spending decisions of domestic citizens who are investing in these assets.

In a climate of generalized capital outflow, previous episodes indicate that those economies most likely to suffer adverse impacts are those with weaker macroeconomic fundamentals (see box 1.3). The fundamentals of concern are inflation rates, current account deficits, budget deficits, foreign sovereign and corporate debt and domestic household debt levels. In the case of the current account deficit, even a low level may be a concern if there are foreign debt payments to service and foreign exchange reserves are not perceived to be sufficient for that purpose. India and Indonesia are among the economies with sizeable amounts of foreign debt maturing in the next few years. India has short-term foreign debt of nearly $90 billion, or more than 20% of total external debt (Reserve Bank of India, 2014), while Indonesia has short-term debt of nearly $50 billion, or more than 15% of GDP (Bank

Box 1.3. Enhancing macroeconomic fundamentals to cope with a likely increase in borrowing costs

Monetary policy normalization in the United States is widely expected to occur in the second half of 2015. The Federal Reserve projected in March 2015 that the federal funds rate would rise from virtually 0% at the beginning of the year to 0.625% by year-end, and increase by another 125 basis points each in 2016 and 2017 (Lebovits and Woolrich, 2015). The long-run interest rate is expected to reach 3.75%. Although Asia-Pacific economies may not have to raise their domestic interest rates by as much as that in the United States, in view of the still stronger economic outlook for the region, higher borrowing costs in the coming years would be unavoidable.

A possible global financial panic that could result from a sharper or earlier-than-expected rate hike may be dealt with in part by capital flow management and macroprudential measures. A more medium-term issue is what countries could and should do in order to cope with an upward interest rate adjustment. One clear option is to enhance macroeconomic fundamentals, which would help lower a country’s perceived risks and thus domestic interest rates. This would involve, among other things, achieving sustainable debt levels, fiscal discipline, price stability and a healthy financial sector.

Based on the Oxford Global Economic Model, an attempt is made below to quantify the impact that improved macroeconomic fundamentals could have on domestic interest rates and economic growth in eight selected Asia-Pacific economies during the period 2015-2017. For each economy, stronger fundamentals are assumed to reflect in a 1-notch upgrade in credit rating on foreign-currency debt as well as a 100-basis-points reduction in the risk premium on debt denominated in United States dollars. In the Oxford model, changes in these two variables affect other macroeconomic variables, such as long-term government bond yields and short-term interest rates.

Box 1.3. *(continued)*

Figure A below depicts the actual interest rates in 2014, the interest rates in 2017 under the baseline as projected by the Oxford model and the estimated interest rates in 2017 under the scenario with stronger macroeconomic fundamentals. The figure shows that the interest rates are generally expected to trend up between 2014 and 2017.[a] The key finding is that, compared with the baseline, improved macroeconomic fundamentals would help to lower the estimated interest rates in 2017, by about 1.2 percentage points in the Republic of Korea and Turkey and up to 1.4 percentage points in Indonesia and the Russian Federation. Although monetary policy normalization in the United States will likely require emerging Asia-Pacific economies to raise their interest rates in order to maintain capital inflows, the required increase could be smaller, by 1.2-1.4 percentage points, if these economies secure more favourable macroeconomic fundamentals in the coming few years.

Figure A. Actual and simulated interest rates under the scenario of better macroeconomic fundamentals

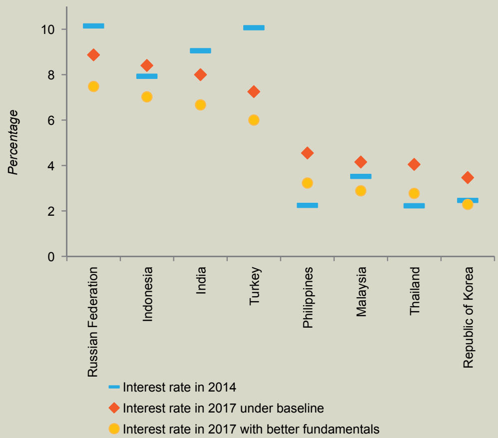
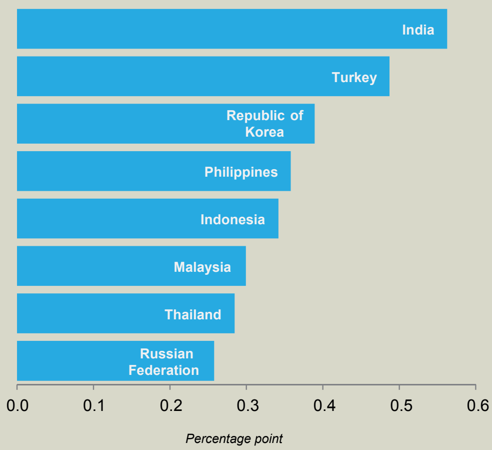


Figure B. Percentage point change in annual GDP growth relative to the baseline during 2015-2017



Source: ESCAP, based on the Oxford Global Economic Model.

A smaller required increase in the interest rates would help these economies to achieve more rapid economic growth relative to the case where macroeconomic fundamentals remain unchanged. In particular, lower borrowing costs would support economic growth through fixed investment and household spending. Figure B above shows that, relative to the baseline, annual economic growth in India could be up to 0.6 percentage points higher per year during the period 2015-2017. Similarly, in the Philippines, the Republic of Korea and Turkey, the positive impact of stronger macroeconomic fundamentals on economic growth, through lower interest rates, is estimated to be 0.4-0.5 percentage points per year.

[a]The key exceptions are the Russian Federation and Turkey, where interest rates have surged recently in response to capital flight, which is likely to be a transitory phenomenon.

Indonesia, 2015). Economies which displayed some of these macroeconomic weaknesses in the past, such as India, Indonesia, Malaysia and Turkey, were those that suffered the most impacts in the previous bout of capital outflows at the start of United States “tapering” of monetary policy during mid-to-late 2013. In the current circumstances, another macroeconomic weakness which will play an important role is excessive dependence on commodity-related revenues, as has been seen in outflows from the Russian Federation.

The threat of capital outflows will play an important role in determining the monetary policy stance for affected economies. From the inflation standpoint, most economies in the region are expected to see declining inflation expectations primarily due to moderate oil prices. This would support a reduction in interest rates by central banks. However, interest rates may need to be kept higher in order to compensate for relatively weak macroeconomic fundamentals by offering higher potential returns to investors. This, in turn, could depress economic growth through the domestic channel by making investment more costly and reducing the attraction of consumption as compared with saving. Economies are faced with this dilemma as long as they maintain relatively flexible exchange rates and allow uninhibited mobility of capital across borders. Consideration may therefore need to be given to how best to strike a balance between maintaining monetary flexibility to pursue domestic objectives and using measures necessary to manage capital flows.

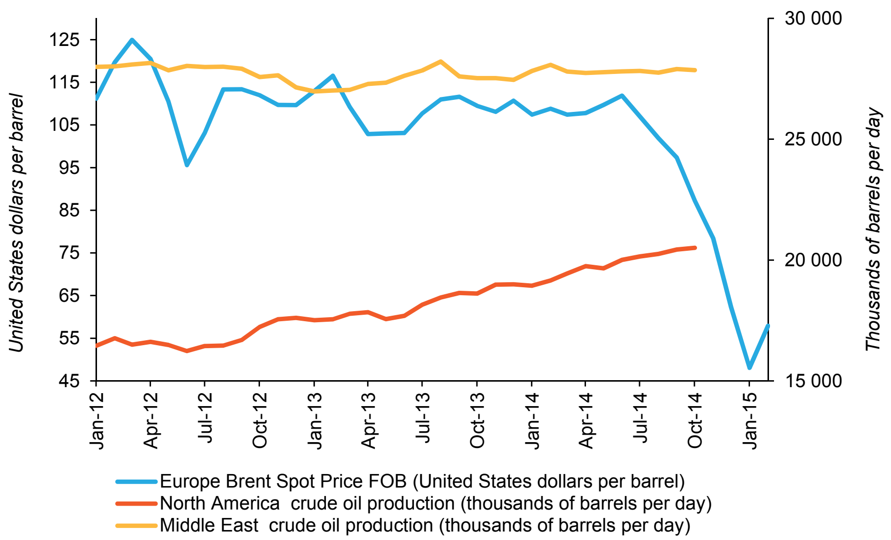
2.2.2. Impact of oil price developments

A major global development has been the sharp drop in oil prices since mid-June 2014, which maybe the start of a longer-term trend (see figure 1.11). The price of Brent crude has dropped by 50% between mid-June 2014 and mid-April 2015. The overall impact of falling oil prices will depend on the nature of oil-dependence (oil-importing or oil-exporting) of economies, the prevailing level of inflation and the fiscal policy stance pertaining to subsidies. For many economies globally, including Asia-Pacific economies, the impact of falling oil prices has been mostly positive as this phenomenon has reduced inflation, mitigated current account pressures, and increased disposable income of households. Lower oil prices also provide an opportunity for some economies to divert spending away from untargeted energy-related subsidies to development spending, which may help the long-term growth prospects of those economies. However, for some major oil-importing economies, the dramatic fall in oil prices has led to deflationary pressures, which could have a negative influence on growth. This scenario has led to conventional (lower interest rates) and unconventional (quantitative easing) policy responses with implications for capital flows and increased volatility in asset prices/exchange rates.

Both demand and supply factors have contributed to the dramatic decline in international oil prices. The demand effect is the result of fragile, low and slowing growth in some of the major economies of the world – China, Japan and eurozone countries. The International Energy Agency in October 2014 lowered its estimate of global oil demand for 2014 by 250,000 barrels a day to 7 million barrels per day, suggesting that global oil demand grew at its slowest pace in 5 years. Further, the oil-intensity of global activity has steadily declined and almost halved since the 1970s as a result of increasing energy efficiency and declining oil-intensity of energy consumption. Global growth in 2015 is expected to remain weak. Thus, conditional on the supply dynamics, it may be expected that relatively low oil prices will persist. Global oil supply has also repeatedly been a source of surprises on the upside, a factor that is contributing to the oil price decline. A major new development has been a considerable increase in shale-oil production in the United States. In February 2015, the country pumped 9 million barrels per day, a 9% increase over the level of the previous year and only slightly less in total than that pumped by Saudi Arabia. At the same time, OPEC, by maintaining its production levels, has clearly indicated that its policy objective has moved from targeting an oil price band to maintaining its market share.

Although the exact relative importance of demand and supply factors for oil prices is difficult to quantify,

Figure 1.11. Oil production in the Middle East and North America, and Brent crude spot price, 2012-2015



Sources: ESCAP, based on data from United States Energy Information Administration. Available from http://tonto.eia.doe.gov/dnav/pet/pet_pri_spt_s1_d.htm; and CEIC Data. Available from ceicdata.com (accessed 30 March 2015).

it appears from various analyses that the main cause of the price fall has been supply conditions (World Bank, 2015). Various estimates put the break-even oil price for the most expensive shale producers at $60-70 a barrel. Below this price, some production would be taken off-line. This is indeed what has happened with some United States oil producers in recent months. Going forward, it can be reasonably expected that the oil supply may decline somewhat on the margin as new investments in oil production, especially in the United States, become increasingly unprofitable at the current very low prices. On the other hand, some oil producers using traditional extraction methods, most notably Saudi Arabia, can produce oil at far lower prices, estimated to be about $20 a barrel. This enables such countries to attempt to price shale competition out of the market by ensuring persistence of lower oil prices. However, it should be noted that fiscal spending in such countries is dependent on oil prices remaining at levels higher than those currently prevailing. Therefore, oil prices at such low levels are also not sustainable in the long term. Such a reading of the oil market implies that there would be a floor to the oil price around the $60-$70 a barrel range. The moderate rebound of oil prices in early 2015 from their minimum at the start of the year is perhaps an indication that the market may be adjusting itself to such a sustainable floor.

For oil-exporting economies, there would be negative impacts on growth, with the degree depending on the extent of industrial diversification of economies apart from the energy sector. Thus, the most adversely affected economies in the Asia-Pacific region would be highly oil-export-dependent economies, such as the Russian Federation and other Central Asian producers, as well as the Islamic Republic of Iran. Spillover and transmission channels to other economies would occur through trade and remittance ties with oil-producing economies: for example, North and Central Asian economies with the Russian Federation, and the Philippines and South and South-West Asian economies with Middle Eastern producers. As migrant workers generally hold vulnerable jobs, they would be the first to be affected by a potential deterioration of the economic situation in their host country.

For oil-importing economies, some of the macroeconomic implications of oil-price developments are that there would be greater monetary policy space due to lower inflation and improved current account balances. However, decisions on interest rate reductions will depend on the sustainability of the oil price decline and the strength of overall balance of payments positions. Moreover, if the oil price decline proves to be relatively short-lived, which has been perhaps suggested by the moderate increase in prices during 2015, the interest-rate-reduction-induced increase in inflation could turn out to be excessive, and this may induce excessive capital outflows and currency depreciation. Oil-exporting economies face a dilemma. A tight monetary policy stance is required in the short term to ward off exchange rate depreciation pressures, as is the case in the Russian Federation where the policy interest rate now stands at 14%. Higher interest rates, however, could choke economic activity in these economies just as growth is already suffering impacts from reduced oil exports.

In terms of fiscal policy, oil-importing countries with fuel subsidies have the opportunity to create fiscal space by removing the subsidies and thus release funds for inclusive and sustainable growth. Currently, fiscal space is being created in some countries as the subsidy is not being activated at low oil prices. However, the fiscal space created could be made permanent by removing such subsidies altogether while minimizing the immediate impact on the poor segments of society. Such removal has already been done to a significant extent in the Asia-Pacific region by India, Indonesia and Malaysia. These countries have pledged to use some of the savings to increase development spending, particularly on infrastructure, health and education, and targeted cash transfers to the poor. For oil-exporting economies, fiscal space will be drastically reduced in some cases, increasing government debt and decreasing Governments' ability to fund development spending. For example, according to the Finance Minister of the Russian Federation in January 2015 the break-even oil price for maintaining the budget of the Russian Federation is $70 a barrel.

3. POLICY CONSIDERATIONS

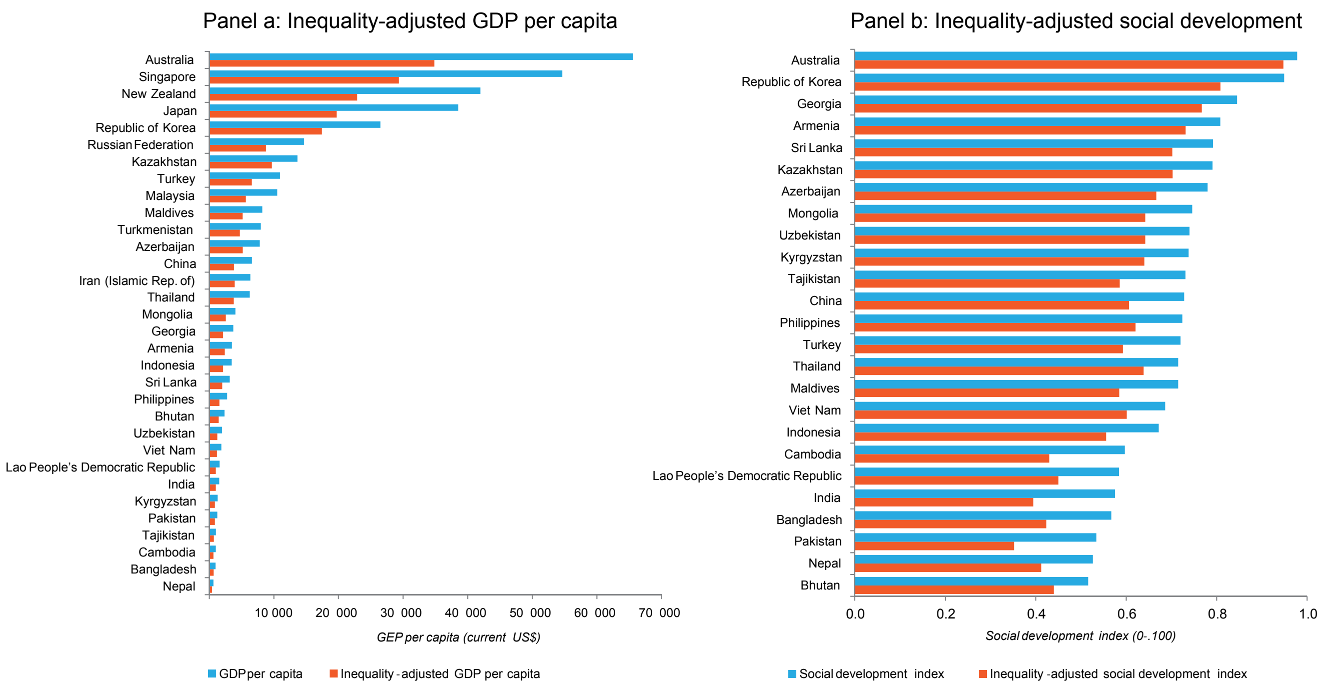
3.1. Dealing with obstacles to inclusive growth

Income inequality impeding progress

Recently, income inequality has emerged as a significant concern for policymakers across the globe. One reason among many for this concern is the cost it imposes on achieving inclusive growth and development. The issue of inequality is garnering further attention during the ongoing formulation of the sustainable development agenda for the United Nations development framework beyond 2015. While overall economic growth and poverty reduction have shown steady improvement over the past decade, ESCAP estimates indicate that income inequality, as measured by the Gini coefficient, has widened significantly in the Asia-Pacific region. Specifically, the coefficient has risen from 33.5 in the 1990s to 37.5 in 2000s. In particular, the estimates show that about 84% of the region's population now lives in countries with a Gini coefficient ranging from 33.9 (India) to 42.1 (China) for the most recently available data. Importantly, the level of income inequality is now high in countries with different levels of development status. For example, the Asia-Pacific least developed countries have experienced an increase in the income inequality level from 30 in the 1990s to 34.5 in the 2000s, while the landlocked developing countries have experienced an increase from 32.7 to 35.7 during the same period.

ESCAP analysis indicates that high levels of inequality are undermining the economic and social achievements of the region. To estimate the negative impact, the analysis discounted levels of per capita income for 32 countries in the region with available data by a factor proportional to the extent of income inequality. The findings show that GDP per capita declines substantially for many countries with relatively high Gini index levels. For example, GDP per capita (current dollars) for 2013 in Kazakhstan declined from $13,650 to $9,686 when adjusted for income inequality. In the case of China and India, the decline was from $6,626 to $3,839, and from $1,548 to $1,023, respectively (see figure 1.12, panel a). Similarly, the ESCAP analysis also considered discounting of levels of development achievement by a factor proportional to the extent of inequality – in a manner similar to that used for the inequality-adjusted human development index. This analysis used a "social development index" which combines the education and life expectancy components of the human development index. Using data for 25 Asia-Pacific countries, each dimension's average value can be discounted according to the country's level of inequality in education and life expectancy. The results show that the discount is particularly high in several developing countries, including least developed countries in the region, such as Bangladesh and Cambodia, where this inequality-adjusted social development index shows a potential loss of more than 25% in 2012 (see figure 1.12, panel b).

Figure 1.12. Inequality-adjusted GDP per capita and index of social development, 2012-2013



Sources: ESCAP, based on data from UNDP, *Human Development Report 2013 -- The Rise of the South*: Human Progress in a Diverse World (New York, 2013); ESCAP, *Statistical Yearbook for Asia and the Pacific 2014* (ST/ESCAP/2704, Bangkok); and United Nations Statistical Division.

Inclusive growth contingent on gender equality

A fundamental obstacle to inclusive growth is patriarchy. Inclusive growth cannot be achieved without addressing the discrimination, oppression and subjugation of women and girls, in both the public and private domains, across the Asia-Pacific region. Moreover, under the prospective development agenda beyond 2015, realization of sustainable development goals – for which people, prosperity and the planet are fundamental – necessitates transformative and substantive changes that address the structural causes of gender inequality and injustice. In this respect and taking two sectors as examples, the partial, and in some instances complete, exclusion of women from the economic realm and that of political governance needs to be addressed. As well as being a matter of human rights, women's economic participation has repeatedly been linked to poverty eradication and to sustainable development with, for example, rises in individual income levels and in a country's productivity rates. Addressing the gender imbalance in leadership and decision-making is also critical for inclusive growth; without equality in representation, men's voices (and their needs and interests) will continue to drown out those of women.

Women's lower rates of labour-force participation than of men have, for instance, been associated with GDP per capita losses (Elborgh-Woytek and others, 2013) and increased participation rates with GDP gains from 5% to 34% (Aguirre and others, 2012). Beyond the quantitative aspects, measures in support of inclusive and equitable growth must tackle occupational segregation wherein – and reflecting traditional and restrictive, gender roles – women predominate in vulnerable employment, characterized by low pay, low productivity, restricted occupational options and little, if any, social protection (Economist Intelligence Unit, 2012). Also related to the economic realm and critical to inclusive growth is the recognition, respect and redistribution of reproductive work, given that reproductive work enables productive work and is disproportionately done by women (and girls).[25] Accordingly, policies and legislation need to: (a) prohibit discrimination on the basis of sex (and other characteristics, including age, sexuality and disability); (b) provide maternity protection; and (c) facilitate "return-to-work", such as through nursing facilities and access to affordable and high-quality childcare. In terms of the gender imbalance in leadership, currently in the Asia-Pacific region, women constitute approximately 18% of national parliamentarians. In approximately one third of the countries in the ESCAP region today, less than 10% of national parliamentarians in single and lower houses are women.[26]

Lack of decent jobs

Achieving inclusive growth must be underpinned by the provision of sufficient decent jobs. High-quality employment that is productive and well-remunerated is critical for raising living standards, particularly for workers and households at the bottom of the income ladder. However, the region is still struggling to create adequate jobs in the formal sector and improve overall job quality. Employment has increased by 21.3 million (or 1.2%) in 2014, a slight deceleration from trends in 2013, in developing Asia-Pacific economies.[27] However, employment growth varied across the region in 2014, driven by differences in economic and demographic trends. The South Asian subregion alone contributed nearly three fifths of the region's employment growth.

In order to achieve inclusive growth for all women and men, improving employment prospects for young people in Asia and the Pacific is essential. In particular, youth unemployment was about 10% or higher in 7 of 13 economies with recent figures. In Sri Lanka, for example, 19.5% of youth in the labour force were unemployed, with the situation being even more alarming for young women (26.3%). Likewise, in Indonesia and the Philippines youth unemployment was about 14-19%, partly reflecting considerable growth in the youth labour force. These regional trends are driven by a number of age-specific factors, including the mismatch between education, employers' requirements and youth aspirations. In India, for instance, youth unemployment is about 1 in 10 overall, but nearly 1 in 4 among better educated young women from wealthier, middle class families (Huynh and Kapsos, 2013).

While job creation is key for realizing inclusive growth, equally important is ensuring that the quality of employment is high and income from work is stable and sufficient. In terms of enhancing job quality, progress was uneven in developing Asia and the Pacific in 2014. Overall, 611.6 million workers (or 34.2% of the total number employed) were engaged in agriculture, where work is less productive and working conditions are often poor. A key obstacle in achieving inclusive and sustainable growth is the widespread vulnerable employment in developing Asia and the Pacific. Workers in vulnerable employment are less likely to have decent earnings, formal work arrangements and access to social protection, which are all critical components for boosting living standards. Vulnerable employment, consisting of own-account and contributing family workers, totalled more than 978 million (or 54.7% of the total number employed) in 2014.

3.2. Mobilizing finance to boost infrastructure for development

While traditional sources of finance to meet government spending needs for infrastructure development will remain critical, it will also be important to use innovative sources of finance, especially of the private sector, to bridge the wide financing gap in many developing economies in the region. Traditional sources of government development finance, primarily tax receipts and overseas development assistance, have proved inadequate in meeting the large development requirements of economies, including those related to infrastructure. On the other hand, it is true that there are large sources of capital available within the region, primarily with the private sector and in the shape of large foreign exchange reserves. These funds, if effectively mobilized, could be used for investment in development projects. Improving the methods of intermediation through national and regional initiatives, thus, can go a long way in achieving this objective.

A basic requirement for increased participation of the private sector in development projects in general, and in infrastructure projects in particular, is a supportive legal and regulatory environment. Many economies in the region are currently deficient in this respect. One example is the restriction in some economies on government subsidies to complement public-private partnership schemes. Such subsidies are sometimes required as the stand-alone revenues of a welfare-enhancing project may not be sufficient to attract the private sector. Legislative changes are thus required to permit such subsidies. Encouragingly, these are being put into place in some countries, including in Indonesia, the Philippines and Thailand, and should serve as a guide to others. Governments can also set up strong institutions to support infrastructure project participation by investors. Some positive examples are the Public-Private Partnership Center of the Philippines and the Indonesia Infrastructure Guarantee Fund Project. A guiding principle should be that when such institutions are set up they are constituted with sufficient decision-making responsibility to be effective. Another area of regulatory improvement is ensuring the establishment of procurement procedures which ensure transparent bidding.

Effective engagement of regional capital markets can also significantly increase financing sources available to the Government to boost spending in development projects. The development of local currency bond markets will be particularly useful in this regard. Local currency bond markets are attractive for Governments as they reduce currency and maturity mismatches. They are also valuable as a source of long-term investment for savings of the region's ageing population. However, these markets currently lack the depth, liquidity and legal safeguards required to attract investors in sufficient numbers to finance infrastructure needs. Foreign currency issuance continues to be popular in the region, with issuance from East and North-East Asian developing economies reaching a record of almost $200 billion in 2014 (Ng, 2015). However, the recent rise in the dollar clearly highlights the risks of such issuance in terms of the local currency burden on issuers. Well-structured and well-regulated bond markets would improve investor confidence, reduce market-entry barriers, broaden investor participation and boost regional cooperation.

The entry of new development banks focused on infrastructure, although a welcome development, may not be enough to fill the financing gap. However, they can provide important support to the capital markets and the private sector. The Asian Infrastructure Investment Bank (AIIB)[28] created by China and the New Development Bank (NDB)[29] created by the BRICS economies (comprising Brazil, the Russian Federation, India, China and South Africa) are useful new initiatives in the quest to meet the region's infrastructure needs, together with the work of existing development banks in the region. However, the quantum of the new banks' planned lending is considerably below the total estimated requirements for infrastructure development in the region — more than $800 billion a year. The authorized capital of AIIB is $50 billion while that of NDB is $100 billion, with the latter devoting its capital to both infrastructure and sustainable development projects. One possibility for achieving larger returns is to leverage the credit rating of these institutions to guarantee infrastructure bonds issued by domestic entities.[30] The issuance of a large pool of infrastructure bonds guaranteed by multilateral institutions would help spur additional investment by increasing the depth and liquidity of local bond markets. More generally, the multilateral development banks and other international organizations can support the private sector by assisting in standardizing regulatory regimes, as well as designing financing structures which can function across countries.

Other than financial markets, the other key approach to increasing private sector involvement in infrastructure projects is through public-private partnerships (PPPs). The potential to increase infrastructure PPPs is clear. Infrastructure PPPs in the region currently account for a small proportion of total global infrastructure PPPs, by one estimate only 8% of the total between 2008 and 2014 (Pregin, 2015). There are a number of key considerations in order to ensure the development of a pipeline of successful PPP projects in countries in the region. These are: (a) creating a strong national legal framework; (b) deciding on appropriate projects by careful economic and financial analysis that considers social, environmental and budgetary implications of projects; (c) selecting projects which can be continued under different political administrations as the timescale will involve several successive Governments; (d) understanding which projects will be appealing to the private sector; (e) creating a standardized and transparent bidding and selection process; (f) choosing reliable revenue streams that will keep paying throughout the projects; and (g) engaging deeply with stakeholders in the community to ensure that there is public buy-in to the projects.

3.3. Macroprudential policies to manage capital volatility and support monetary policy

The prevailing economic conditions of declining inflation and volatile capital flows have made the issue of efficacy of monetary policy highly topical. Conceptually, monetary policy is hamstrung if falling inflation is accompanied by capital outflow pressure. This is because interest rates would have to remain relatively higher to protect currency values than what is called for in view of the domestic inflation trends. Central banks in the region overwhelmingly have price stability as one of their explicit objectives. Of the 15 major central banks in the region, 13 have explicit numerical targets for inflation. However, a number of central banks also have an explicit requirement to maintain exchange rate stability and therefore manage the volatility of capital flows – specifically 5 of 15 major central banks in the region have made exchange rate stability a policy objective. In any case, central banks have to be concerned with capital flow volatility because of its effects on domestic financial stability. While financial stability is not an explicit objective for most central banks, it is clearly an issue of concern given its implications for the real economy and as indicated by the steps that have been taken to reduce financial sector vulnerability since the 1997 Asian financial crisis. For example, short-term external debt-to-foreign currency reserves ratios have been brought down and loan-to-deposit ratios of banks have been lowered.

Current methods to manage capital volatility while preserving monetary policy flexibility raise a number of concerns. Apart from using key monetary policy instruments, many economies currently have accumulated large amounts of foreign exchange reserves to manage the potential impact on exchange rates of any future capital outflow. However, such intervention could entail costs incurred in sterilizing the effect of foreign exchange accumulation on domestic liquidity. The cost to the exchequer is due to the interest rate differential between holding foreign currencies that earn low rates of interest as compared with the higher interest rates paid when issuing domestic bonds for sterilization. Furthermore, the issue of domestic bonds can increase financial market risks. This is because the availability of relatively safe and cheap lending may lead to riskier investments by the domestic banking sector. More fundamentally, the use of exchange rate intervention does not address the impact of capital market volatility on domestic asset markets. Sharp falls in asset markets, such as equities, bonds and property, can have adverse impacts on the wealth of citizens as well as on the financial stability of banks invested in the asset markets.

Macroprudential policies offer an important complementary method of managing capital flows. They directly target the source of instability of capital flow volatility, namely the domestic asset markets in which capital flows are invested. Such policies are defined as regulatory policies that are aimed at reducing systemic risks, safeguarding the stability of the financial system as a whole against domestic and external shocks, and ensuring that it continues to function effectively (Bank for International Settlements, 2010). Rather than changing the cost of borrowing for the entire economy, macroprudential policies are targeted at controlling credit to what central bankers see as specific areas of financial excess.

Macroprudential policies can be grouped into: (a) caps on loan-to-value ratios, such as those in the housing sector; (b) limits on credit growth and other balance sheet restrictions, such as debt service limits on credit cards and personal loans; (c) explicit ceilings on banks' credit growth; and (d) capital and reserve requirements and surcharges, such as countercyclical capital requirements and higher reserve ratio requirements (Claessens, 2014). Typically, macroprudential policies differ from capital flow measures, which are meant to limit capital flows by non-residents. Capital flow measures can be foreign-currency based, such as limits on foreign exchange borrowing, reserve requirements on foreign exchange deposits, and provision requirements on foreign exchange lending; or they can be residency-based, such as unremunerated reserve requirements on non-resident deposits, withholding tax or restrictions on non-resident holdings of domestic assets. However, on occasion macroprudential policies may also include capital flow measures, such as in the case of policies to discourage foreign-currency borrowing. Macroprudential policies are normally enacted by central banks and are complementary to fiscal measures undertaken by Governments, such as increasing taxes and stamp duties on investors in certain sectors.

Macroprudential measures are particularly useful because they target the particular sectors of the economy which are deemed to be most important for maintaining financial stability. Such policies are targeted primarily at the banking sector, which is the main component of the financial industry in the region. Also, macroprudential measures can be targeted at the housing sector, which is known to be fundamental to financial stability, as was seen during the financial crisis in the United States and the eurozone. A significant amount of wealth in the region is contained in the housing sector; therefore, the bursting of any asset bubbles in this sector due to capital outflows would have far-reaching effects for economies. Macroprudential measures related to credit growth and reserve requirements are also important as excessive leverage raises the risk of significant negative impacts on the economy from a credit crunch due to capital outflows.

The region has significantly expanded its use of macroprudential measures and capital flow measures since the start of the 2008 financial crisis. One study found that 391 macroprudential and capital flow measures had been implemented in the region since 2000, of which 294 were implemented since September 2008 (HSBC, 2014). Of these, macroprudential measures accounted for the overwhelming majority, and within these measures, policies were predominantly housing-related. A number of economies used mainly housing-related measures after the start of the crisis, namely Hong Kong, China; Malaysia; and Singapore, whereas some employed them even before the crisis – China, India, the Republic of Korea and Thailand. In Hong Kong, China, the main housing-related macroprudential measure was tightening loan-to-value ratios between 2010 and 2012, which was accompanied by government fiscal measures to increase stamp duties. Similarly, Singapore tightened loan-to-value ratios and increased property-related taxes. Malaysia has progressively raised property taxes since 2010. China has been actively increasing loan-to-value ratios and property taxes since 2005. Thailand introduced the loan-to-value ratio measurement in 2003; it has been gradually implementing it on a range of property classes, and higher risk weights have been placed on mortgages. India has increased the risk weights on mortgages since 2005, although generally the use of housing-related macroprudential measures has been limited.

Apart from housing-related measures, economies have been active in utilizing credit-related measures to manage excessive credit growth. China and India have been prominent in using the reserve ratio requirement for credit management, whereas other economies have mainly used other credit control measures. Since the 2008 crisis, China and India have used the reserve ratio requirement as a key variable to control credit. Other economies have used measures often targeted at household debt. The Republic of Korea tightened loan-to-deposit ratios. A number of South-East Asian economies – Indonesia, Malaysia, the Philippines and Thailand – have controlled growth in the use of credit cards. Similarly, car loan costs have been managed in Indonesia and Singapore.

Despite the enactment of a number of proactive macroprudential measures in recent years, there are significant risks to financial stability across the region, which would benefit from implementation of further measures. Property prices have continued to rise in a number of economies despite some moderation due to already implemented macroprudential measures. Particular rises can be seen in China; Hong Kong, China; Malaysia; and Thailand. Household debt is a large and growing problem in a number of East and North-East Asian and South-East Asian economies. General credit growth by the banking sector is also a concern for some economies. GDP growth in the region has become more credit-intensive since the 2008 crisis, making economies particularly susceptible to a hike in global interest rates. China is the most prominent example of an economy with concerns about excessive credit growth, with its GDP growth being the most credit-intensive in the region apart from the financial centres of Hong Kong, China; and Singapore. Other economies with private debt ratios-to-GDP of between 150% and 200% include Malaysia, the Republic of Korea and Thailand.

3.4. Diversification of commodity-dependent economies

Fiscal frameworks to address procyclicality

Many commodity exporters have quasi-fixed exchange rate regimes which limit the role of monetary policy under capital mobility. As such, fiscal policy is often the main tool for macroeconomic management against shocks. Fiscal policy, however, suffers from the natural procyclical tendency of Governments to spend more when revenues are strong. Addressing this is a challenge for all countries but especially so for commodity exporters, the revenues of which tend to be more volatile. This is because commodity-related tax and royalties often account for a significant share of the revenue base and also because commodity shocks tend to spill over into the wider economy and thus the general tax base. In the past decade, an increasing number of countries have adopted fiscal rules (Schaechter and others, 2012). There are different types of fiscal rules. One of them involves defining some numerical targets for budget balance, revenues or expenditures which are independent of the business cycle. For instance, member countries in the European Union subscribe to the Stability and Growth Pact ceilings on government deficit (3% of GDP) and debt (60% of GDP). An example from the Asia-Pacific region is the fiscal rule of Kazakhstan, which caps the annual transfer from the oil fund to the national budget at $8 billion and the interest cost of the public debt to 4.5% of the oil fund's balance.[31] Although these rules are simple and transparent, they may lack the flexibility needed in the light of changing economic circumstances.

An alternative is to focus instead on stabilizing the structural balance, or "cyclically adjusted balance", which is the difference between government spending and the estimate for trend government revenue. This approach is in line with the permanent-income approach and the emphasis is on shielding government spending from large revenue shocks. A number of countries, including Chile, Germany and the United Kingdom of Great Britain and Northern Ireland, fall under this category; in the Asia-Pacific region, only Australia has such as rule. Chile, however, is unique in correcting not only for the cyclical influence of the business cycle but also for the cyclical deviations of the price of copper from trend. The Government sets a cyclically adjusted balance target, using independent forecasts of trend output and trend commodity prices produced by two panels of experts. The country's experience has been successful. Chile has a one-third share in global copper production, and this represents more than half of Chile's total exports. However, the country has managed to lower the standard deviation of output growth from 3.5% in the 1990s to 2.2% in the 2000s, even though copper price volatility exploded from $0.2 per pound for the metal to $1.10 per pound during this period (Schmidt-Hebbel, 2012).

Fiscal rules are often, although not always, accompanied by fiscal responsibility laws. Chile enacted such a law in 2006 to strengthen the institutional framework for a fiscal rule adopted five years earlier by a previous administration. The law requires a new administration to define and publish the fiscal policy framework for its four-year term and its implications for the Government's structural balance. It also requires yearly estimation of the structural balance and contingent liabilities. Under the law, two funds were established: the pension reserve fund and the economic and social stabilization fund. The pension reserve fund accumulates funds at a yearly floor rate that is equivalent to 0.2% of GDP and a ceiling of 0.5%. When there is a budget surplus, the windfall revenue first pays for the pension reserve fund, with any remainder being transferred into the economic and social stabilization fund. When there is a deficit, payment for the pension reserve fund and government spending are withdrawn from the economic and social stabilization fund. The law also established a financial advisory committee to advise the Ministry of Finance on investment regulations and decisions related to the two sovereign wealth funds. In the Asia-Pacific region, India, Pakistan and Sri Lanka have fiscal responsibility laws that contain specific numerical targets, while Australia and New Zealand have fiscal responsibility laws which are focused more on procedural aspects.[32] With respect to the management of sovereign wealth funds, several countries, including Azerbaijan, Brunei Darussalam, Kazakhstan, the Russian Federation and Timor-Leste, have relatively well-specified rules and regulations.

Decisions on government spending should be based on careful value-for-money and cost-benefit analysis. This is important as Governments are often pressured or tempted to simply increase spending in periods when commodity prices are high. Studies show that commodity booms often result in increased spending on investment projects and the government wage bill.[33] While investment in well-selected, productivity-enhancing infrastructure is desirable, unviable projects could be stranded without funds for completion or maintenance when commodity prices drop. Higher public sector wages could help to reduce incentives to extract illegal incomes and therefore reduce corruption, but higher wages too are difficult to reverse when commodity prices drop.

In conclusion, fiscal rules could be a useful tool for providing a credible medium-term anchor to fiscal policy and curbing procyclical tendencies. However, in the case of developing countries, where the demand for basic public social services and infrastructure development is high, fiscal rules should be carefully adopted so as to not hinder the developmental role of fiscal policy.[34] It should be emphasized that fiscal rules do not necessarily address, and could even constrain addressing, fundamental problems, such as inadequate budget allocation on social spending and infrastructure, which are important for the long-term health of economies and for economic diversification.

Monetary and exchange rate policies for stability and diversification

The conduct of monetary policy in developing countries often requires a strong anchor for inflation expectations, some nominal variable to which the central bank commits and is observable and influenced by the central bank. At the same time, such economies often experience large supply shocks, especially fluctuations in their terms of trade. Typically, they cannot depend on countercyclical capital flows to smooth out the effects of such shocks. Of the nominal variables that could potentially anchor expectations, fixed exchange rate or target zones were popular until the currency crises of the 1990s, after which inflation targeting has been the dominant trend, at least until the 2008 global crisis, which brought financial stability considerations to the fore. While there are various forms of inflation targeting, such as core, headline, expected and actual, almost all of them focus on the consumer price index. However, CPI may not be the best choice of a price index for a country that is subject to volatile terms of trade. Indices have been suggested which are more production-oriented rather than consumption-oriented so as to automatically accommodate fluctuations in the export price while furnishing a nominal anchor for inflation expectations. The producer price index, for instance, could be modified to weight sectors not according to gross sales but rather value added, as in the national income accounts.[35]

During a commodity boom, there is often a large real appreciation in the currency, usually in the form of nominal currency appreciation under a floating exchange rate, as in the case of such countries as Australia, Kazakhstan and the Russian Federation during the period 2001-2008. Partial sterilization of foreign exchange inflows could help to alleviate the upward pressure on domestic demand and the exchange rate, albeit not always very effectively. This could be done through external debt reduction, investment of commodity-related revenue abroad, or redirection of government purchases towards imports (Medas and Zakharova, 2009). In situations of extreme pressure on the exchange rate, countries could also consider imposing temporary controls on capital inflows. Beyond stabilization concerns, maintaining a competitive exchange rate is important for economic diversification through the development of tradable sectors, particularly manufacturing.

Industrial and foreign direct investment policies for diversification

As part of industrial policy, the Government, the private sector and civil society could come up, in a participatory manner, with the required supportive policies, incentive structure and institutional arrangement to ensure flows of investment into the strategic sectors. For instance, they could target the promotion of new products and services that are higher value added and that allow for further diversification of the economy. Such policies differ from those which provide incentives for any new investment regardless of its productivity and diversification-enhancing potential. In this context, certain infant industries could be supported, for instance through tax incentives. At the same time, general supportive infrastructure would be important.

Commodity exporters could recycle their resources revenue to start off the diversification process. Malaysia presents a case of diversifying from an initial condition of strong concentration in the mineral sector. Primary commodities accounted for some 70% of Malaysia's exports in the 1960s. However, manufacturing has since risen from 5% to about 70% of merchandise exports, and its composition has shifted towards higher-technology products, such as machinery. Major infrastructure investments and targeted support were important in developing a competitive manufacturing base. Export promotion through targeted tax incentives and a competitive exchange rate also played their role. Similarly, Indonesia actively encouraged agriculture in the face of a booming oil sector in the 1970s; it also undertook large investments of oil income to develop natural gas resources. In the 1980s, Indonesia moved towards low-wage manufacturing and an export-oriented strategy so that by the mid-2000s manufacturing represented nearly half of merchandise exports.

Another way to facilitate strategic diversification is through attracting foreign investment while ensuring meaningful linkages and spillovers into the local economy and local enterprises. When Viet Nam liberalized FDI in the 1990s, FDI was initially concentrated in the oil sector, but other sectors, including real estate, food processing and heavy and light industry, gradually gained in importance. This helped Viet Nam integrate into emerging global supply chains and gradually diversify its output and exports from textiles to footwear and electronics.

International cooperation

Commodity exporters that fall under the least developed country category may take advantage of certain preferential arrangements. For instance, Bangladesh's initial diversification benefited from the introduction of the Multifibre Arrangement in 1974. This helped Bangladesh shift away from producing traditional agricultural and jute products towards manufacturing ready-made garments. While the garment industry has helped create more jobs, including for female garment workers, subsequent efforts to move beyond garments have been hindered by a lack of supportive reforms.

Furthermore, the traditional diagnosis to shift labour from agriculture to manufacturing may not be fully appropriate for some countries in view of their small population size, which limits economies of scale, and for some others with high transport costs arising from geographical constraints. In particular, for small island developing States specialization in certain high value-added goods and services may be more appropriate. These economies may also benefit from subregional cooperation. Special arrangements, such as market access or labour migration to nearby major economies, could also help promote positive structural change.

3.5. Addressing climate change concerns and issues of sustainable energy

Emerging approaches to addressing climate change

Climate change poses threats to sustainable development as the adverse impacts of climate change can cut back decades of development gains. In Asia and the Pacific, impacts of climate change have been manifested in various ways, including the melting of Himalayan glaciers in Bhutan and Nepal, sea level rise in Bangladesh and small island developing States in the Pacific, and increased intensity and frequency of extreme weather events, such as heat waves, cyclones/ typhoons, tornadoes, intense rainfall, droughts and dust storms in many countries.

The most vulnerable to these impacts are the poor. They are disproportionately affected by the climate change impacts, and they lack the means and capacity to respond to them. Vulnerability of least developed countries to these impacts has been recognized in the various decisions under the United Nations Framework Convention on Climate Change. For the inclusive and sustainable development of the region, it is critical that appropriate measures be taken to address climate change.

While the efforts to adapt to climate change impacts are necessary, especially for vulnerable countries, all the countries in the region should accelerate their mitigation efforts in their respective national contexts of sustainable development to prevent further rises in global temperature and intensified climate impacts. As mentioned previously, COP 21 will be held in Paris in December 2015. That session is aimed at adopting “a protocol, another legal instrument or an agreed outcome with legal force under the Convention applicable to all parties” beyond 2020 to limit global warming to a rise of no more than 2°C. As part of the process leading up to COP 21, all parties to the Convention are invited to communicate to the UNFCCC secretariat their intended nationally determined contribution towards achieving the objectives of the Convention.

Areas to be covered by the intended nationally determined contribution include mitigation along with adaptation, finance, technology development and transfer, capacity-building and transparency of action and support. Asia and the Pacific accounted for more than half the world’s GHG emissions in 2011.[36] The countries in the region that are parties to UNFCCC have been invited to formulate and communicate to the secretariat of UNFCCC their intended nationally determined contributions well in advance of COP 21.

The challenge of mitigation is that it is often seen as a burden to economic growth; however, countries could consider mitigation efforts as an opportunity to transform their current economic systems from being resource-intense to resource-efficient and low carbon. The region’s rapid economic growth in past decades has been based on intense use of natural resources, which as a result was accompanied by high and rising levels of environmental damage. For the region’s further growth over the long term, the region should shift away from resource-intense growth to resource-efficient growth. In other words, the key to long-term growth lies in the concept of doing “more with less” – achieving more growth with less resources. Low-carbon growth based on this concept will be an important strategy for the region. Some countries in the region, including Cambodia, Mongolia and the Republic of Korea, have already adopted low-carbon green-growth approaches in their national strategies.

To turn the mitigation of climate change effects into opportunities, the policy instruments for mitigation should be aimed at generating co-benefits or double-dividends while paying attention to inclusiveness. A recent publication proposed specific policy instruments in this regard (ESCAP, 2012c). For example, properly designed environmental tax reforms and environmental fiscal reforms can be instrumental in lowering environmental impacts and simultaneously generating higher growth and employment thereby creating a double dividend. Environmental tax reforms entail shifting the bases of taxes from conventional levies on labour and income to environmentally damaging activities, such as use of natural resources or environmental pollution, while maintaining the tax revenue as neutral. Evidence from countries that introduced such reforms indicates that they have had positive impacts on competitiveness and income regressiveness. With implementation of such reforms, the Asia-Pacific region alone could reduce global CO_2 emissions by up to almost 7.9% by 2020. Thus, environmental tax reforms can provide an opportunity for developing countries in particular to put their economies onto a different and more resource-efficient development path.

GHG mitigation also presents an opportunity to reduce air pollution, which has adverse impacts on health, environment and economies. Air pollution is a persistent or emerging problem in many cities of the region as it can cause respiratory and other diseases, lead to premature death, environmental damage and reduced agricultural productivity, and ultimately lead to the loss of the productivity of economies. Policies intended to generate co-benefits from the mitigation of GHG and air pollution can range from setting standards for reduction of pollutants to banning certain practices and tools that produce specific air pollutants, such as open burning of agricultural waste and using traditional coke ovens and biomass cook stoves, and subsidizing the purchase of cleaner and more resource-efficient tools (Japan, Ministry of the Environment, 2014).

Developing countries in particular should promote nationally appropriate mitigation actions that can generate environmental, social and economic co-benefits in the context of sustainable development. Such actions refer to “any action that reduces emissions in developing countries and is prepared under the umbrella of a national governmental initiative”.[37]

Least developed countries are characterized by low contributions to past and projected future GHG emissions until 2050. Global climate action should include (a) supporting least developed countries so that they can initiate actions towards building low-carbon economies, especially as they intend to graduate from least developed country status on the one hand, and (b) recognizing their limited means to mobilize domestic financing and technology on the other.

Ensuring energy security

Energy security is a pressing concern for regional sustainable development for a number of reasons. First, due to the extraordinary economic growth in recent decades, energy demand in the region has increased significantly and is expected to grow continuously in the foreseeable future. Overall, Asia and the Pacific became a net total primary energy supply (TPES) importer in 2007, and in 5 years, by 2012, net TPES import for this region had increased to 385.5 million tons of oil equivalent (Mtoe). Second, fossil fuels have been and will continue to be the major energy source in the region, accounting for more than 60% of the total final energy consumption (ESCAP, 2014d). Compared with the soaring energy demand, fossil-fuel reserves are unevenly distributed in the region, leading to many developing countries depending on imported fossil fuels and therefore exposing them to energy price volatility in the international market. Third, although there have been improvements in energy use, energy-intensive and carbon-intensive growth have resulted in multiple challenges, such as air pollution, threats to public health and harm to economic competitiveness.

Ensuring long-term energy security and the sustainable use of energy is a critical challenge for continuous economic growth and energy development. Discussions on regional energy security issues led to the establishment of the Asian and Pacific Energy Forum in 2013, the first intergovernmental conference of energy ministers held under United Nations auspices in the region. A five-year plan of action on regional cooperation for enhanced energy security and the sustainable use of energy was adopted by the Forum. The agreed vision was to make sustainable energy for all a reality, ensuring that there will be enhanced energy security from the regional to the household levels; ensuring an energy future of equity, diversification and access to all is secured; and ensuring the share of cleaner energies in the overall energy mix is increased (ESCAP, 2013b). Sustainable development is not possible without sustainable energy. Energy security can be leveraged by expanding energy access, developing renewable energy and improving energy efficiency – the three objectives of the United Nations Sustainable Energy for All initiative. Together with UNDP and ADB, ESCAP has formed a regional hub to implement that initiative, which is aimed at providing universal access to modern energy services, doubling the global rate of improvement in energy efficiency and doubling the share of renewable energy in the global energy mix.

Advancements in the power generation sector, including falling costs of variable renewable energy-generation sources,[38] as well as increasing efficiency in the use of coal and solar energy generation, have positive implications for sustainable growth globally and within Asia and the Pacific. As of 2012, renewable energy accounted for approximately 17% of electricity production in the Asia-Pacific region, up from 15% in 2000.[39] Three factors make variable renewable energy a critical theme requiring in-depth examination within the context of energy development in Asia and the Pacific. First, the barriers to capturing variable renewable energy resources are getting lower. Second, Governments, the private sector and the general public are increasingly turning towards variable renewable energy, for power production. The Asia-Pacific region has emerged in the past few years as a leader in the production and adoption of variable renewable energy technologies. Third, the Asia-Pacific region has the opportunity to transition to more flexible, stable, cleaner and cost-effective future energy systems that can better integrate the power resources of both today and tomorrow. Incentives exist to turn to the cheapest and easiest fuel and technology solutions to meet this need. However, not planning for long-term economic, social and environmental costs, or not developing energy systems that can better integrate shifting resources and emerging technologies, may result in inability to meet future demand in an economically cost-effective manner.

The levelized costs of electricity for some renewable energy-generation technologies have become comparable to fossil-fuel power generation, especially when factoring in such externalities as potential health and carbon dioxide-related costs. Policies promoting the use of renewable energy as well increasingly efficient fossil-fuel combustion technologies should be implemented within the region in order to facilitate their more rapid deployment. Key factors to accelerate deployment include the availability of low-cost public and private financing for new sustainable power projects as part of a stable investment landscape, such incentives as generation-based feed-in tariffs and mandatory power-purchase agreements with utilities for renewable energy power producers to off-take their power, and swift and effective procedures for permitting grid connections. A combination of these factors, among others, can be promoted through effective policy that places importance on the creation and expansion of a secure and sustainable energy grid with a combination of diverse and sustainable generation sources.

Endnotes

1 The proposed goals are 17 in number, and there are 169 associated targets covering a broad range of sustainable development issues. For more details, see two recent reports: United Nations (2014a; 2014b). They are available from, respectively, www.un.org/ga/search/view_doc.asp?symbol=A/69/700&referer=/english/&Lang=E, and www.un.org/ga/search/view_doc.asp?symbol=A/68/L.61&referer=/english/&Lang=E.

2 For an overview of sustainable development trends and challenges, see ESCAP (2014c). Available from www.un.org/ga/search/view_doc.asp?symbol=E/ESCAP/FSD/1.

3 The developing economies referred to here do not include the economies of the North and Central Asian subregion as they are considered transition economies. If those economies were included, then the growth forecast would decrease to 4.9% in 2015 compared with 5.3% in 2014. For the region as a whole, including developed economies, the growth forecast for 2015 is 3.4%, down from 3.5% in 2014. See table 1.1 for more details.

4 For India, the growth forecast for 2015, the estimated growth for 2014 and the actual growth for 2013 use rebased numbers announced by the country's Central Statistical Office in February 2015. The rebased numbers use FY2012 (fiscal year from March 2011 to March 2012) as the new base. It is worth noting that rebased growth for India in FY2012 was 6.9%, whereas the previous figure for FY2012 was 4.7%. Similarly, aggregate growth for developing ESCAP economies (excluding those in the North and Central Asian subregion) for 2013, using pre-rebased FY2012 data for India, was 5.7% as compared with 6% using the rebased numbers for India.

5 Expected and forecast growth for India refers to rebased numbers released by the Central Statistical Office in February 2015. See footnote 4 above.

6 As with growth forecasts, this inflation outlook pertains to developing economies, excluding the North and Central Asian subregion. If that subregion is included, the inflation forecast for 2015 would increase to 4.3% (the same as in 2014) since the economies in that subregion are experiencing the highest rate of inflation in the Asia-Pacific region.

7 For details, see "To get the economy up and running", *The Hindu Business Line*, 16 December 2014. Available from www.thehindubusinessline.com/opinion/to-get-the-economy-up-and-running/article6698055.ece.

8 For details, see "Commodity price crash: risks to exports and economic growth in Asia-Pacific LDCs and LLDCs", *ESCAP Trade Insights*, Issue No. 6, March 2015. Available from www.unescap.org/sites/default/files/Trade%20Insights%20No.%206.pdf.

9 The other commercial services category, in turn, contains eight subcategories, but the data are not readily available for all countries. In addition, the number of years for which data are available is very different across countries, and in most cases they are limited to just a few years. See box 2.3 of the *Asia-Pacific Trade and Investment Report 2012* for a more detailed explanation of this service category (ESCAP, 2012a, pp. 38-39).

10 When intra-European Union imports are excluded, this share comes close to 40% (WTO, 2014).

11 All FDI data are from UNCTADStat, except for greenfield FDI data which are from fDi Intelligence, and data on mergers and acquisitions, which are from Thomson Reuters. Estimated FDI data for 2014 are given where available from the UNCTAD Global Investment Trends Monitor, published on 29 January 2015.

12 Although the developing Asian region defined by UNCTAD does not cover the same countries as the Asia-Pacific region defined by ESCAP, the coverage is similar enough to identify similar trends.

13 The "going global" strategy was adopted by the Government of China in 2001, under which Chinese firms were encouraged to look for overseas opportunities. It was further broadened in 2013 with adjustments in the regulatory framework for outward FDI to assist Chinese firms to be competitive abroad. See Sauvant and Chen (2014).

14 The Russian Federation's advancement in the World Bank "Doing Business" ranking, from 111th place in 2012 to 65th place in 2015, indicates a reduction in the cost of operating a business and an overall upgrading of the country's business environment. For additional information, see www.doingbusiness.org/data/exploreeconomies/russia/.

15 In 2013, the FDI inflows into the Russian Federation were exceptionally high due to a single "mega deal" worth $55 billion, that is, the Rosneft-British Petroleum transaction in March that year.

16 For details, see "Risk or reward? The trouble with Southeast Asia's infrastructure", *Wall Street Journal,* 29 May 2014. Available from http://blogs.wsj.com/indonesiarealtime/2014/05/29/risk-or-reward-the-trouble-with-southeast-asias-infrastructure/.

17 The Eurasian Economic Union is a trade bloc that includes Armenia, Belarus, Kazakhstan and the Russian Federation; it was officially launched on 1 January 2015.

18 The Shanghai Cooperation Organisation is a Eurasian political, economic and military organization which was founded in Shanghai in 2001 by the leaders of China, Kazakhstan, Kyrgyzstan, the Russian Federation, Tajikistan and Uzbekistan.

19 The Silk Road initiative was proposed by China in 2013 to integrate the economies of Asia and Europe along the Eurasian corridor with that of China.

20 The "noodle bowl" effect is a phenomenon of international economic policy that refers to the complication which arises from the application of domestic rules of origin in the signing of free trade agreements across nations. The effect leads to discriminatory trade policies because the same commodity is subjected to different tariffs and tariff reduction trajectories for the purpose of domestic preferences.

21 For instance, see Auer and Vignold-Majal (2014). For an alternative, longer-term view, see Canuto (2014).

22 For example, sugar prices may fall as countries such as Brazil increase their production in the light of lower ethanol prices.

23 Countries in this category include Australia, Azerbaijan, Bhutan, Brunei Darussalam, Indonesia, the Islamic Republic of Iran, Kazakhstan, Malaysia, Mongolia, Myanmar, Papua New Guinea, the Russian Federation, Timor-Leste, Turkmenistan and Viet Nam.

24 For instance, see IMF (2012), chap. 4.

25 It is noted that sustained increases in women's labour-force participation require a multiplicity of actions, inclusive of repealing discriminatory policies and legislation, tackling oppressive sociocultural norms and practices and eliminating horizontal and vertical occupational segregation.

26 For global and regional averages of such participation, see www.ipu.org/wmn-e/world.htm.

27 Throughout this section, regional and subregional labour market estimates and trends are based on ILO (2014; 2015).

28 As founding members, representatives of 21 countries in the Asia-Pacific region signed a memorandum of understanding on establishing the Asian Infrastructure Investment Bank, when they met in Beijing on 24 October 2014. For further information, see http://news.xinhuanet.com/english/business/2014-10/24/c_133740149_2.htm.

29 The New Development Bank was agreed by BRICS leaders at the 5th BRICS summit held in Durban, South Africa, on 27 March 2013. See Brazil, Ministry of External Relations (2014). Available from http://brics6.itamaraty.gov.br/media2/press-releases/219-agreement-on-the-new-development-bank-fortaleza-july-15.

30 For further information, see Gordon French, "How Asia should pay for $11tn in infrastructure needs", *Financial Times*, 26 November 2014. Available from http://blogs.ft.com/beyond-brics/2014/11/26/guest-post-how-asia-should-pay-for-11tn-in-infrastructure-needs/.

31 In 2012, Kazakhstan modified the rule on annual transfer of funds to the budget from the fixed amount to the flexible amount of $8 billion plus or minus 15%, depending on the cyclical position of the economy.

32 Examples from the region are: Australia's Charter of Budget Honesty Act 1998; India's Fiscal Responsibility and Budget Management Act, 2003; New Zealand's Public Finance Act 1989 as amended in 2004; Pakistan's Fiscal Responsibility and Debt Limitation Act, 2005; and Sri Lanka's Fiscal Management (Responsibility) Act No. 3 of 2003.

33 For instance, see Medas and Zakharova (2009).

34 For further information on this matter, see a discussion by Anis Chowdhury and Iyanatul Islam, entitled "Fiscal rules – help or hindrance?", published on Vox CEPR's Policy Portal. Available from http://voxeu.org/debates/commentaries/fiscal-rules-help-or-hindrance.

35 This paragraph draws on Frankel (2012).

36 Details of the magnitude of those emissions are provided by the World Resource Institute. Available from http://cait2.wri.org/wri/Country%20GHG%20Emissions?indicator[]=Total%20GHG%20 Emissions%20 Excluding%20Land-Use%20Change%20and%20Forestry&indicator[]=Total%20GHG%20 Emissions%20Including%20Land-Use%20Change%20and%20Forestry&year[]=2011&chartType=geo.

37 For additional details, see http://unfccc.int/focus/mitigation/items/7172txt.php.

38 Variable renewable energy sources include wind, solar, wave and tidal sources.

39 Further information is available through the APEF Energy Data Policy Information Portal of ESCAP. This sentence also contains data obtained from IEA.

2

SUBREGIONAL PROSPECTS AND POLICY CHALLENGES

The Asia-Pacific region is enormously diversified in terms of size of population, economic structure and levels of development across countries and subregions. The region is home not only to some of the richest and fastest-growing economies in terms of economic growth but also to numerous poor and struggling economies with serious development challenges. In order to gain a better understanding of economic prospects and structural impediments to inclusive growth and sustainable development, this chapter therefore provides a disaggregated analysis of the macroeconomic performance and outlook at the subregional and country levels. The chapter also contains a discussion of some immediate and medium-term policy challenges specific to each subregion, thereby providing an opportunity to learn from a variety of experiences and policy considerations.

East and North-East Asia. Despite a revival in the United States economy, economic growth in this export-oriented subregion moderated in 2014 due to subdued domestic demand. In China, the shift towards more sustainable, consumption-led growth has resulted in slower growth in fixed investment. Similarly, in Japan output growth has stalled, with larger-than-expected quarterly contractions following the consumption tax hike in April 2014. Fiscal stimulus was launched in both China and Japan, as well as in the Republic of Korea, to combat tepid growth. In terms of outlook, economic growth is projected to increase modestly over 2015 and 2016 due a slight pickup in Japan and stronger growth momentum in the Republic of Korea. China's economic growth, however, is expected to trend downwards slightly more.

An immediate policy challenge for East and North-East Asia is to cope with slowing demand from China. In this regard, efforts are being made to enhance trade connectivity and lower barriers to trade. Examples include the Chinese-led initiative to set up an Asian Infrastructure Investment Bank and the formation of a free trade agreement between China and the Republic of Korea. The Governments of countries in the subregion also introduced policies to boost domestic demand as an alternative source of growth, but their success will be constrained by the currently high debt levels and rapidly ageing population. It is estimated that 1 in 4 persons in East and North-East Asia will be at least 65 years old by 2050. Policies to address the multifaceted nature of an ageing population, such as job sharing and innovative financial products, are critical to overcome medium-term challenges.

North and Central Asia. The already sluggish economic growth in the Russian Federation in recent years was exacerbated by lower global oil prices and geopolitical tensions and related international sanctions. As a result, the economy barely grew in 2014, while considerable contraction is expected over 2015/16. As the Russian Federation accounts for 80% of economic output in North and Central Asia, subregional growth performance and prospects are also bleak. To its neighbouring countries, the Russian Federation is the main trading partner and host country for migrant workers. Already, subdued foreign exchange earnings due to declining commodity prices have led to the weakening of several of the subregion's currencies. Thus, unlike elsewhere in Asia and the Pacific, inflationary pressures are rising in North and Central Asia. This leaves the subregion in a low-growth, high-inflation situation.

Sources of economic growth in North and Central Asia are highly concentrated. In Azerbaijan, Kazakhstan, Turkmenistan and Uzbekistan, natural resources rent, defined as the difference between a commodity's price and its average production cost, amounts to between 37% and 47% of GDP. In Armenia, Kyrgyzstan and Tajikistan, overseas workers' remittances account for between 13% and 41% of GDP. Such concentrated economic structure makes countries in the subregion highly vulnerable to developments in global commodity prices and macroeconomic conditions in the Russian Federation. Policy reforms to diversify sources of economic growth would involve creating a dynamic, entrepreneurial private sector and strengthening the linkages between resource- and non-resource-based sectors.

The Pacific. Pacific island developing economies grew at a three-year high rate in 2014. The expansion took place in nearly all those economies, but growth was driven mainly by mineral resource production in Papua New Guinea, which accounts for close to 60% of output of those economies. A devastating cyclone led to an economic contraction in Solomon Islands in 2014, which highlights the subregion's vulnerability to frequent natural disasters. Catastrophes often disrupt economic growth and macroeconomic stability, given the small populations, limited land area and restricted room for macroeconomic policy response in those island economies. In terms of outlook, economic growth is projected to increase further, benefiting from strong mineral exports in Papua New Guinea, continued post-cyclone reconstruction activity in some countries and expected increases in tourism and remittance receipts. A major obstacle would be any decrease in the price of primary commodities, which could dampen the earnings of rural residents.

Faster output growth is needed to generate more jobs in Pacific island developing economies where many people remain unemployed or still engage in subsistence activities. Limited infrastructure networks and human and institutional capacity have resulted in the subregion's low and uneven economic growth record. A more vibrant business sector would expand the economic base, reduce youth unemployment and support government revenue that could be spent to reduce notable gaps in service delivery in rural areas and outer islands. Countries have made progress in promoting private sector development but more effort is needed to promote niche, higher-value-added industries, such as sustainable tourism and fishery activities.

South and South-West Asia. Economic growth in 2014 edged up but remained far below the subregion's impressive performance prior to the 2008 global crisis. The uptick was led mainly by stronger macroeconomic performance in India, which accounts for slightly more than half the output in the subregion. Economic growth also strengthened in Bhutan, Nepal, Pakistan and Sri Lanka, and was stable at rather high levels in Bangladesh and Maldives. Robust household consumption largely propelled the expansion, which benefited from favourable farm incomes, revived workers' remittances and eased monetary policy. The outlook for 2015 and 2016 is optimistic. Continued domestic reform effort would help unleash high potential growth that the subregion gains from a young population and abundant farm workers who can move to higher value-added manufacturing activity.

Despite the commendable economic growth that helped reduce poverty in past decades, the South and South-West Asian subregion still accounts for nearly 40% of the world's poor. Three interconnected macroeconomic imbalances, namely large fiscal deficits, sizeable current account shortfalls and high inflation, have held back faster economic growth in the subregion. Tax reforms would help lower public borrowings, which have added inflationary pressure to the economies, contributed to wide saving-investment gaps and constrained financing for the private sector. In addition to macroeconomic imbalances, severe power shortages are a key growth constraint. As the root causes of the energy crisis lie beyond energy sector policies, a broad-based policy effort is needed to expand the fiscal space, set up an appropriate framework for public-private partnerships and enhance corporate governance in public enterprises.

South-East Asia. Economic growth momentum softened in 2014 amid monetary tightening and weak commodity exports in Indonesia, political unrest in Thailand and cooling of the real estate sector in Singapore. Growth also slowed, albeit from a high base, in subregional economies with lower income levels, such as Cambodia, the Lao People's Democratic Republic and Myanmar. The near-term outlook is projected to improve, mainly underpinned by an economic recovery in Thailand and more rapid growth in Indonesia and the Philippines. Lower global energy prices would keep prices low, although oil-dependent Brunei Darussalam and Timor-Leste will likely face revenue shortfalls.

An increasing role has been observed in South-East Asia with regard to domestic demand, particularly private consumption, in supporting economic growth. While this helps raise the subregion's resilience against external demand shocks, such consumer spending is financed largely by capital inflows amid a situation characterized by abundant global financial liquidity. In Malaysia and Thailand, an increase in the value of household debt during the period 2008-2013 was equivalent to nearly 30% of those countries' GDP. Regarding medium-term challenges, two key growth constraints are shortages of public infrastructure and skilled labour. As for infrastructure, the subregion needs to mobilize part of its available savings, about $700 billion in international reserves, to reverse the declining trend in public infrastructure outlays. This would complement multilateral initiatives, such as the ASEAN+3 Bond Market Initiative.[1] With regard to workers' skills, while most countries in the subregion have achieved universal primary education, secondary enrolment should be actively encouraged and the quality of education and vocational training should match the needs of job markets.

1. EAST AND NORTH-EAST ASIA

1.1. Key economic and social themes

The East and North-East Asian subregion is composed of economies with diverse economic structures and at various stages of economic development: from labour-abundant China and capital- and technology-rich Japan to the natural resource-endowed Mongolia. Hong Kong, China and the Republic of Korea are also distinctive in their heavily export-driven economic structure. Well-known as two of the "Four Asian Tigers", the two economies achieved rapid economic development based on exports and are now global leaders in financial services and information technology, respectively. The Democratic People's Republic of Korea, on the other hand, is a centrally planned system and has only limited ties to the global market.

These differences enhance economic complementarities and provide opportunities for greater linkages among economies in East and North-East Asia. At the same time, for these economies to create shared prosperity through enhanced connectivity, the subregion needs to bridge the large development gap, which currently has Japan on one end of the development spectrum and the Democratic People's Republic of Korea and Mongolia on the other.

An immediate challenge for economies in East and North-East Asia is the economic slowdown in China, which is part of its process of economic rebalancing. Since the global financial crisis in 2008, the strategy of the Government of China has been to gradually transition from relying on the export of manufactures and investing in support of economic growth to develop the service sector and foster consumption. Consequently, China's growth rate has declined from double-digit levels prior to the global financial crisis to about 7.4% in 2014. Export growth has substantially slowed from an average of about 30% per annum between 2001 and 2008 to less than 10% in recent years. Fixed asset investments, which have been one of the primary engines of growth of the Chinese economy, are also slowing from a growth rate of about 26% between 2008 and 2011 to 15% in 2014.

China has long since been the largest trading partner for all ESCAP subregional economies. The impact of China's rebalancing has been channelled to neighbouring economies in East and North-East Asia through reductions in trade flows (see figure 2.1). In the case of Mongolia, there has been a reduction in demand for commodities, such as coal and copper, and in the case of Hong Kong, China; Japan; and the Republic of Korea, trade in capital and intermediate goods has fallen in recent years.

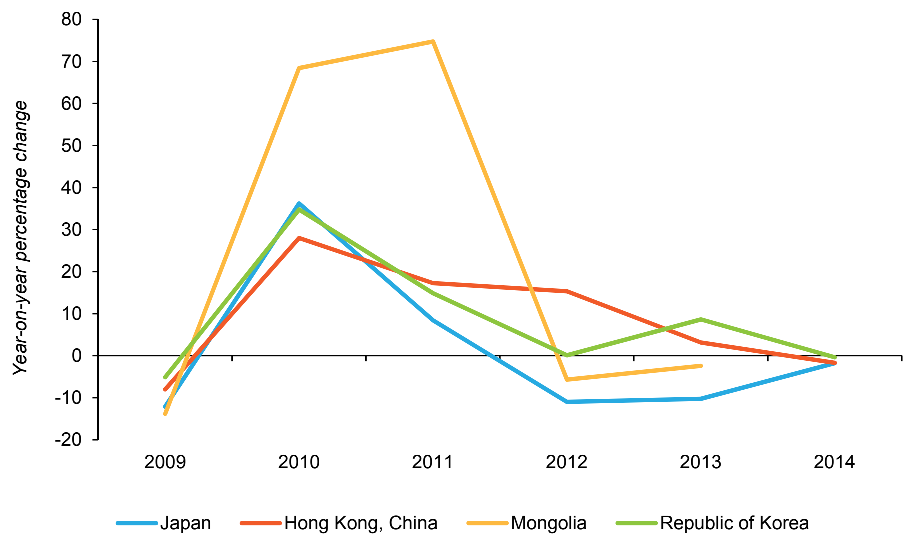
There are various measures that can be taken to mitigate the short-term impact of the decreased trade resulting from China's rebalancing and subsequent drop in economic activity, while maximizing new opportunities. One such measure is to increase trade and logistics connectivity and lower barriers to trade. In launching those efforts, China and the Republic of Korea signed a provisional free trade agreement outlining concessions on manufactured items, with the two countries intending to finalize the agreement in 2015. The agreement is expected to have a direct positive impact on the steel-making industry of the Republic of Korea; the abolishment of the 3% import duty on steel came into immediate effect. Discussions on a trilateral free trade agreement involving China, Japan and the Republic of Korea are also making progress.

Additionally, there are growing opportunities created by new Chinese initiatives on enhancing infrastructure linkages. The rollout of the "one belt, one road" national strategic initiative, which is also known as the "new silk road economic belt" and "twenty-first century maritime silk road", and the proposed establishment of an Asian Infrastructure Investment Bank, as well as the proposed silk road fund should promote large-scale infrastructure investment along the belt and road for the next 5-10 years.

On the social front, population ageing is of increasing concern for the subregional economies. East and North-East Asia is experiencing the fastest population ageing in human history, with the subregional economies having the highest life expectancy (notably Japan) and the lowest fertility rates (Japan and the Republic of Korea) in the world. The speed of population ageing is particularly rapid in China, where persons aged 65 or older are projected to reach close to 200 million (11.7% of the total population) in 2020, and more than 300 million people (22.1% of the total population) in 2040 (see figure 2.2).[2]

The challenges posed by rapid population ageing are multifaceted; they involve the labour force, health services, pension and welfare schemes, housing

Figure 2.1. Annual merchandise export growth to China from selected East and North-East Asian economies, 2009-2014



Source: UNCTAD database.

and issues of poverty and social isolation. In East and North-East Asia, where 1 in 4 persons will be 65 years or older by 2050, the development of policies to support sustainable ageing societies should be a key priority.

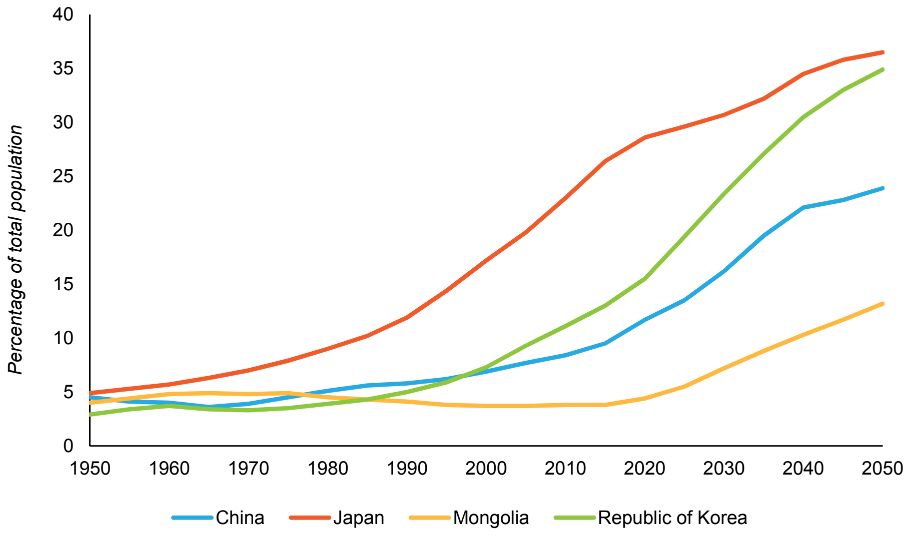
1.2. Recent performance, outlook and main challenges

Economic growth in East and North-East Asia decelerated from 4.2% in 2013 to 3.3% in 2014 (see figure 2.3). The slowdown was recorded in all of the subregional economies except in the Republic of Korea. Despite strong economic recovery in the United States, which helped to mitigate somewhat the impact of slower growth in China, the subregion's growth momentum weakened due to softening private consumption and investment spending. Although export growth slowed in some of the economies, the trade account balance improved across the board as the import bill fell faster.

Sluggish economic activity and subdued international commodity prices resulted in lower inflation in most of the economies in the subregion (see figure 2.4). In fact, deflation became a concern for the Republic of Korea as prices fell below the target of 2%, and deflation continues to be a key challenge for Japan. In response to slower economic growth in most economies in the subregion, the monetary policy stance was broadly accommodative, with China and the Republic of Korea cutting benchmark rates. Japan also expanded its programme of quantitative easing. Mongolia, on the other hand, is struggling to rein in double-digit inflation resulting from rapid depreciation of the domestic currency and added domestic demand generated by the fiscal stimulus in 2013. The pace had started to slow towards the second half of 2014 as credit expansion and currency depreciation moderated with the gradual tightening of monetary policy.

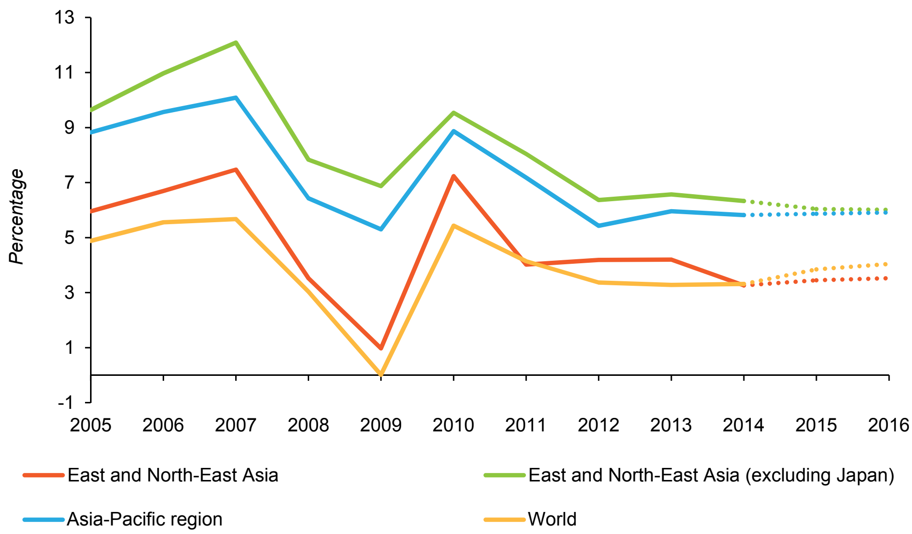
Overall, labour market conditions showed improvement in most economies in 2014. The unemployment rates in China and Japan decreased notably. Hong Kong, China's unemployment rate held steady at 3.3%, which is viewed by the authorities as being close to full employment. The Republic of Korea, on the other hand, experienced worsening unemployment, from 3.1% in 2013 to 3.4% in 2014. For youth unemployment, although the latest available data also showed improvement, the levels remained persistently high at more than double the national unemployment rate in many economies.

Figure 2.2. Proportion of persons aged 65 and older in selected East and North-East Asian economies, 1950-2050



Source: *World Population Prospects:* 2012 Revision. Available from http://esa.un.org/wpp/.

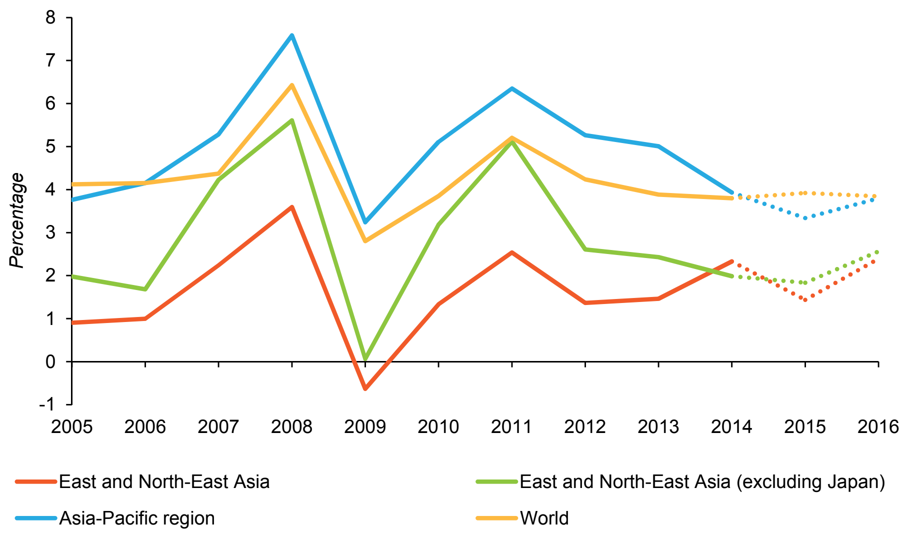
Figure 2.3. Real GDP growth in East and North-East Asia, Asia-Pacific region and the world, 2005-2016



Sources: ESCAP, based on national sources; United Nations, Department of Economic and Social Affairs, *World Economic Situation and Prospects 2015* (Sales No. E.15. II.C.2). Available from www.un.org/en/development/desa/policy/wesp/wesp_current/wesp2015.pdf; IMF, International Financial Statistics databases. Available from http://elibrary-data.imf.org; ADB, *Asian Development Outlook 2015* (Manila, 2015); CEIC Data. Available from www.ceicdata.com.

Note: Estimates and forecasts are as of 31 March 2015.

Figure 2.4. Inflation in East and North-East Asia, Asia-Pacific region and the world, 2005-2016



Sources: ESCAP, based on national sources and CEIC Data. Available from www.ceicdata.com.

Note: Data reflects the changes in the consumer price index. Estimates and forecasts are as of 31 March 2015.

The growth prospects for the subregion remain subdued owing to many challenges ahead. A further slowdown in China, rising geopolitical risks, including in the Middle East and Ukraine, and uncertainties surrounding European economies are likely to weigh down regional economies in 2015. An urgent policy priority would be to develop a clear strategy for shoring up domestic demand while keeping in view high debt levels and a rapidly ageing population in many of the subregional economies.

China

Economic growth slowed to 7.4% in 2014 compared with 7.7% in 2013 and average growth of 9.1% during the period 2010-2012. The contribution to output growth by business investment and household consumption decreased. Nonetheless, net exports remained an important growth driver, underpinned by a significant rise in shipments to the United States and slower import growth on the back of sluggish investment growth, falling commodity prices and currency appreciation.

The rebalancing process, in which the Government seeks to boost consumption to take up the slack from the lower level of investment, has been slow so far. Despite continuing growth in wages and income, national savings have stayed at about half of GDP. On the other hand, policies to boost service sector output are making headway. The services sector continued to expand robustly, accounting for 48.2% of GDP in 2014. To increase the share of services in GDP to more than 50% by 2020, various measures were introduced in 2014, including lowering services taxes, boosting tourism development and increasing access for private investment in the health-care and transportation sectors.

Consistent with the decline in the contribution of investment to GDP growth, FDI inflows were nearly flat in 2014, with a marked shift in investment away from manufacturing to the services sector. On the other hand, the economy recorded strong growth in outward FDI, which already surpassed the inflow of FDI in 2014. FDI outflow from China is going into new sectors, including high technology, agribusiness and food, manufacturing and services.

To maintain growth stability, the Government in April 2014 introduced a mini-stimulus programme that included additional spending on railways, upgraded housing for low-income households and tax reductions for small and medium-sized enterprises. However, implementation of the stimulus packages proceeded cautiously, as local government debt has built up. The Government also reversed restrictions on real estate transactions, such as lowering down payments and mortgage rates for buyers of second homes. Similarly, taking advantage of the low inflation rate of 1.9%, the benchmark lending rate was lowered in November 2014 by 25 basis points, the first monetary easing in two years.

China's economy is forecast to grow by 7% in 2015 and 6.8% in 2016, which is slightly lower than the 7.2% target that the Government previously saw as necessary to ensure stable employment conditions. Importantly, in late 2014, the Government reaffirmed its strong commitment to a new normal of slower but more sustainable economic growth. For instance, in an effort to address the country's severe air pollution problems, the Government plans to cap coal use by 2020, and it agreed with the United States to peak its total carbon dioxide emissions by 2030 or earlier. Without any intervention, China's carbon emissions would have likely peaked in 2050. To reach the carbon reduction target, China has to start rapidly expanding carbon-free energy.

Similarly, the Government is also stepping up measures to tackle the challenge posed by growing income inequality. According to official data, China's Gini index increased from an already high value of 41.2 in 2000 to 49.1 in 2008, before slightly decreasing to 47.4 in 2012. One of the notable policy measures is to reform the non-salary income of government officials and executives at State-owned enterprises.

Hong Kong, China

Economic growth moderated from 2.9% in 2013 to 2.3% in 2014, mainly due to a decline in tourist spending, weaker domestic demand and a decrease in services exports during the first half of the year. The economy saw moderate increases in merchandise exports, but it was not sufficient to offset the slowdown in broader economic activity. Social unrest, particularly in the second half of the year, dampened inbound tourism. Purchases of luxury goods also fell significantly, partially as a result of the strong anticorruption drive of the Chinese Government. Contributing to the growth slowdown was the cooling of property investment, which started in 2013 after the Government introduced measures to manage the sharp increase in real estate prices, which were continued in 2014 in anticipation of a likely interest rate hike in the United States.[3] Meanwhile, overall inflation in 2014 was 4.4%, which is largely stable in view of the rate of 4.3% in 2013. Fiscal stimulus worth about $2.6 billion, tax breaks and one-off cash transfers in the form of rental subsidies lifted price levels.

The economy is forecast to rebound slightly to a growth rate of 2.5% in 2015 and 2.8% in 2016 on an expected improvement in trade-related services. A major challenge is a potential increase in interest rates, which would arise as a result of monetary policy normalization in the United States. After enjoying easy monetary conditions for a long period, which fueled a rise in credit, the higher debt-servicing cost will have negative impacts on consumer spending and business investment.

Macao, China

Macao, China experienced a surprise economic contraction of 0.4% in 2014. The drastic fall in gaming revenue and visitor spending resulted in a 17.2% decline in GDP in the fourth quarter. Although merchandise exports and gross fixed capital formation posted strong growth figures, they could not make up for the fall in the export of gaming services, a sector which accounts for more than 80% of the economy. Moreover, large-scale construction of tourism and entertainment-related facilities is currently adding to concerns about oversupply conditions.

Growth is forecast to contract further by 4% in 2015. Excess capacity in the gaming industry and increasing regional competition from such countries as the Philippines, the Republic of Korea, the Russian Federation and Viet Nam, which are trying to boost tourism through gaming sector development, will be a key policy challenge. As the gaming sector matures in Macao, China, economic diversification towards other services will be critical for achieving stable medium-term growth.

Democratic People's Republic of Korea

The country relies heavily on the export of commodities, such as coal and iron ore, to China as its main source of income. However, with China's economic slowdown and its plan to set a cap on coal consumption as a step towards reducing carbon dioxide emissions by half, the demand from China for coal is likely to fall. This could adversely affect the growth prospects of the Democratic People's Republic of Korea.

In an effort to diversify the economy's structure, the Government is seeking to increase service sector output by streamlining visa processes and designating a special zone for tourism. The Government is also trying to strengthen economic ties with neighbouring countries, including the Russian Federation. The two countries signed an agreement to increase bilateral trade volumes from the current level of $112 million to $1 billion by 2020. Moreover, following the completion of railway upgrades between the two countries in 2013, the Republic of Korea started a pilot project to import coal from the Russian Federation through the Democratic People's Republic of Korea.

Japan

The economy contracted by 0.1% in 2014, after having grown at a rate between 1.6% and 1.8% during 2012/13. Front-loaded consumption spending, especially on capital goods, prior to the consumption tax increase from 5% to 8% in April 2014, resulted in strong economic growth in the first quarter. While some slowing was expected in subsequent quarters, the impact of the tax hike was greater than projected, with economic contractions recorded in the second and third quarters. In response, the Government announced in November 2014 that the second consumption tax increase from 8% to 10%, previously scheduled for October 2015, would be postponed. The unexpected technical recession spurred the Government into enacting another round of stimulus worth $29 billion. The package is aimed at helping low-income households and supporting small and medium-sized enterprises, as well as strengthening disaster prevention and rebuilding disaster-affected areas.

An implication of weak economic growth is that deflation continues to remain a concern. The previous inflation target was set at reaching 2% by April 2015. However, with actual inflation (adjusted for the tax increase) remaining at about 1.5% in 2014 (2.7% if the tax increase is not taken into account), Japan's central bank now expects to reach the target in 2016. The central bank announced in October 2014 that it would expand its quantitative easing programme, aimed at increasing the monetary base from the current 60-70 trillion yen annually to about 80 trillion yen, by purchasing larger quantities of Japanese government bonds alongside riskier assets, such as stocks and property funds. However, without corporations and households tapping in to borrow funds, the link from banks to lenders that creates credit growth and inflation would be weak.

An eased monetary policy stance has already resulted in currency depreciation of more than 30% since 2011. The weaker exchange rate has had a mixed and somewhat unexpected impact on exports. Regarding service exports, tourist arrivals grew by almost 30% in 2014, supported partly by relaxations on visa requirements. However, for merchandise exports there has not been a significant increase. This is potentially due to a low pass-through of exchange rates to export prices, especially among large export-oriented producers, whose import share of the final product tends to be large.[4]

In an effort to meet the 4.1% fiscal deficit target, the Government announced in 2015 that it would cut new borrowings. Japan's public debt has reached 2.3 times GDP, and debt-servicing expenses exceed 23 trillion yen per year. Striking a balance between reining in the debt burden and propping up the economy will continue to be a major challenge, especially in the face of an ageing population.

Growth prospects will continue to be constrained in 2015 with a projected growth rate of 0.6%,before picking up to 0.8% in 2016. Further expansion of the monetary base with plans to switch to higher-yielding stocks has given the equity market a large boost. The wealth effect created by rising stock prices is expected to spur consumption growth. Rising corporate profits may also be translated into larger investment spending in the near term.

Mongolia

Economic growth trended down to a four-year low rate of 7.8% in 2014, from an average growth rate of 13.8% over the period 2011-2013. The key driver of the slowdown is the decline in FDI, along with lackluster performance in non-mining sectors. The mining sector, on the other hand, posted strong growth together with a surge in copper exports. Despite the softening of copper prices amid falling demand from China, which accounts for 40% of global copper exports, production increased significantly from the now operational Oyu Tolgoi mines.

The rapid currency depreciation and strong domestic demand following the fiscal stimulus in 2013 resulted in double-digit inflation in 2014. The price rise nonetheless slowed in the second half of the year, as credit expansion and currency depreciation moderated due to gradual tightening of monetary policy. The policy rate is currently set at 13%, after an increase of 150 basis points in 2014 and another increase of 100 basis points in early 2015.

Economic growth is forecast to moderate to 3.5% in 2015 and 5% in 2016. Mongolia is facing growing challenges from external account vulnerabilities. The sharp decline in FDI has exacerbated the country's deteriorating balance of payments position. Additional pressures will come in the next few years as large external debt repayments are scheduled for 2017/18. Meanwhile, the Government has actively tried to achieve fiscal soundness and deal with the large and growing external debt problem by scaling back government expenditure, as well as by improving transparency through the adoption of the Law of Mongolia on Glass Accounts[5] and the repealing of a law related to the granting of exploration licences, which was one of the main causes of the decline in FDI.

With the mining sector accounting for one fifth of GDP and close to 90% of total exports, as well as 20% of government revenue, the economy is highly vulnerable to the boom-bust cycles of the mineral market. Managing mineral revenue to smooth out the cyclical fluctuations is therefore key to ensuring sustained economic growth. Concurrently, investments of mining proceeds into infrastructure development and viable industries to diversify the export base are an urgent priority.

Republic of Korea

The economy grew by 3.3% in 2014, up from 3% in 2013, but growth remained lower than the average of 4.8% during the pre-crisis years between 2002 and 2007. While the economy gradually recovered, a strong rebound has been difficult to achieve due to mounting domestic and external challenges.

Internally, the ferry disaster[6] in April 2014 notably weakened consumer spending. Property markets remained anaemic, while a large drop in public infrastructure investment in the second half of the year contributed to slowing overall investment growth. Merchandise exports, on which the economy relies heavily to sustain growth, expanded by only 2.1% in 2014 compared with 4.5% in 2013. Meanwhile, inflation in 2014 dipped to 1.3%, significantly below the target range of 2% and sparking concerns about deflation. In response, the Bank of Korea cut rates twice in 2014 and once again in 2015, pushing the benchmark rate to a historic low of 1.75%.

The economy is forecast to expand at the faster pace of 3.4% in 2015 and 3.7% in 2016. Growth should benefit from a $40 billion stimulus package announced in July 2014 and lower borrowing costs. However, further rate cuts may be difficult to execute in the light of the already high level of household debt. The central bank may have to consider alternative means of injecting liquidity in the near future if economic activity remains sluggish and the widening output gap pushes prices down further.

The Republic of Korea has experienced a noticeable decrease in export growth, from double-digit export growth prior to the global financial crisis to less than 3% during 2013/14. In 2014, tepid domestic demand overtook net exports as the main contributor to GDP growth. This sparked concerns about structural issues that may limit the country's medium-term growth prospects. One of these is the weakening of the production value chain. In recent years, the Republic of Korea relied on value-added trade whereby intermediate goods were exported to China and ASEAN countries, where production costs for assembly are lower. However, trade in intermediate goods is expected to diminish more heavily during economic downturns, as exporters of final goods dispose of built-up inventory rather than order new intermediate goods for production. In addition, competition with regard to many of the country's key export products, such as mobile communication devices, display panels and automobiles, is intensifying as markets come close to saturation. The era of export performance feeding into consumption appears to be coming to an end. Innovative strategies for increasing domestic demand are therefore needed to restore growth prospects.

1.3. Selected medium-term policy challenges

In the current economic climate of growing uncertainty concerning external conditions, the subregional economies are increasing their efforts to boost domestic demand in order to close the output gap. Despite the focus of the Governments of countries in the subregion on domestic demand, significant increases in household consumption have been stubbornly difficult to achieve. Given the limitations to what Governments can do through increasing public expenditure, private sector consumption and investment hold the key to sustainable growth in domestic demand.

One of the factors affecting private sector spending is the rapidly ageing population. The impact of an ageing population on national economies is that older persons tend to consume less than younger persons. In a recent analysis in the subregion, it was shown that the rising trend of the current account surplus in the Republic of Korea, which reflects a larger difference between savings and investment, may be attributed partially to the ageing of the baby-boom generation born in the 1960s and 1970s, which has had a positive impact on savings and a negative impact on investment.[7] With further ageing of this population group, both savings and investment rates are expected to deteriorate, along with consumption.

With the exception of Japan, population ageing in the subregion began at an earlier development stage than in other industrialized countries. Finding ways to mitigate the negative impact of an ageing population on economic development is thus a particular challenge. The development of sustainable pension schemes and health-care coverage are the basic requirements to support consistent consumption by the growing elderly population. Governments could also consider innovative policies to support income growth, such as job sharing and creating an environment for finance sector development, in order to diversify investment opportunities for generating additional income.

2. NORTH AND CENTRAL ASIA

2.1. Key economic and social themes

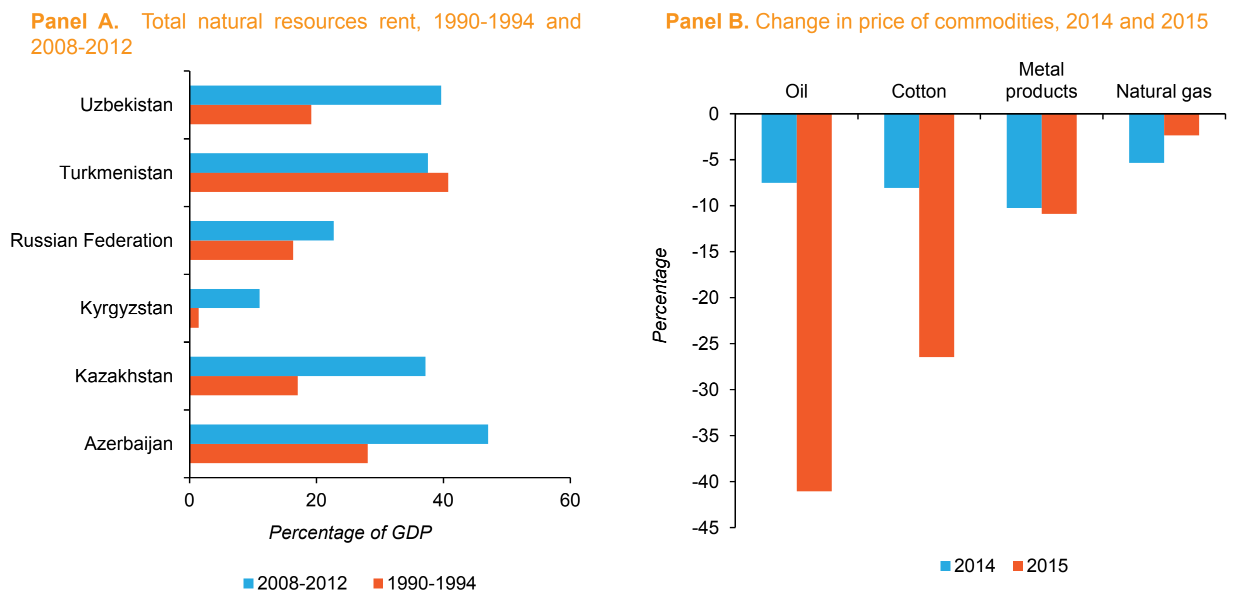
Most North and Central Asian economies rely heavily on the production and export of oil, gas, metals and other commodities. Exports of primary commodities represent more than 40% of total exports in several countries in the subregion. The Russian Federation, which accounts for 80% of output in North and Central Asia, is a significant economic partner of smaller economies in the subregion. Moreover, the Russian Federation is the main host country for migrant workers from neighbouring countries and one of the top three trading partners of most economies in the subregion.

Economic growth in North and Central Asian economies has been driven increasingly by revenues derived from the natural resources sector. Over the last 25 years, total natural resources rent, which is defined as the difference between the commodity price and its average production cost, increased significantly or remained above 30% of GDP (see panel A in figure 2.5). Economies in the subregion are thus being negatively affected by the decline in commodity prices in 2014 (see panel B in figure 2.5). Subdued commodity exports also contributed to the depreciation of local currencies in Armenia, Kazakhstan, Kyrgyzstan and the Russian Federation by at least 10% against the United States dollar at the end of 2014. Azerbaijan and Turkmenistan also devalued their domestic currencies by about 33% and 20%, respectively, against the United States dollar.

Economies in the subregion are struggling with both slower economic growth amid subdued commodity prices and stronger price pressures as a result of the weaker domestic currencies. In the Russian Federation, the impact of lower commodity exports has been exacerbated by geopolitical tensions and related international sanctions, as well as domestic growth impediments. This is likely to exert adverse spillover effects in the entire subregion. Although most net energy exporters in the subregion have sovereign wealth funds, which can be used to partially absorb the adverse impact of falling commodity prices on economic growth, boosts from government spending will be constrained by the need to maintain adequate medium-term fiscal space.

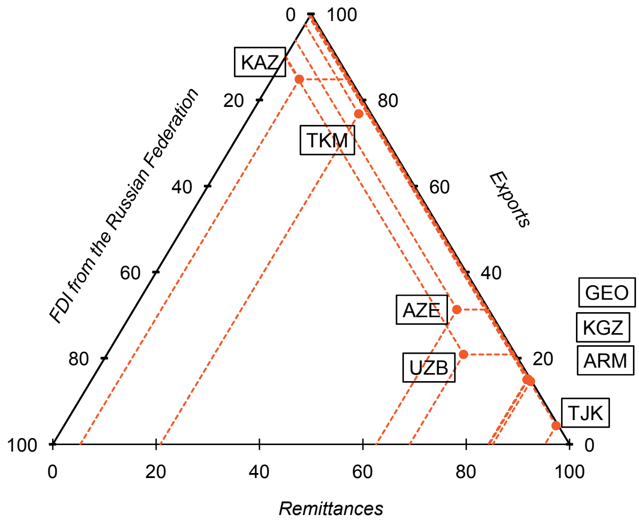
The spillover effects from the Russian Federation to its neighbouring economies tend to work through various channels, but the most significant channel is potentially through the impact on the balance of payments. The ternary diagram in figure 2.6 depicts workers' remittances, exports and FDI inflows that each subregional economy received from the Russian Federation as a share of its total remittances, exports and FDI inflows, respectively. For example, the diagram shows that about 70% of Uzbekistan's remittance receipts are derived from its workers in the Russian Federation (as

Figure 2.5. Natural resources rent and change in price of commodities



Source: ESCAP, based on data from World Bank database and International Monetary Fund's Commodity Price Outlook and Risks, 6 January 2015.

Figure 2.6. Ternary diagram: country linkages to the Russian Federation



Source: ESCAP, based on data from the Central Bank of Russia and CEIC Data.

Note: The position of each dot in the Ternary diagram is determined by the share of each of the three variables (exports, remittances and FDI inflows) in the total foreign inflows received by the country from the Russian Federation. AZE=Azerbaijan, ARM=Armenia, GEO=Georgia, KAZ=Kazakhstan, KGZ=Kyrgyzstan, TJK=Tajikistan, TKM=Turkmenistan and UZB=Uzbekistan.

depicted by a dotted line that connects "UZB", with the triangle side labelled "remittances"). Similarly, about one fifth of Uzbekistan's exports are destined for the Russian Federation. In Armenia, Georgia, Kyrgyzstan and Tajikistan, remittances from the Russian Federation represent at least 85% of total remittance inflows in each economy. The slowing growth of remittance inflows would affect Armenia, Kyrgyzstan and Tajikistan rather notably, given that remittances accounted for between 13% and 41% of GDP during the period 2009-2013.

Overall, the data show that the linkages between the Russian Federation and other subregional economies in terms of remittance flows and export receipts are closer than the linkage on FDI flows. In box 2.1 below, the drivers of remittance flows between the Russian Federation and other North and Central Asian economies are examined further.

The discussion here highlights the need for the subregion to diversify its economic structure and sources of output growth. Countries also need to make more efforts to strengthen domestic demand through private investments and to secure more inclusive growth. This is important because resource-based sectors will not be able to generate sufficient jobs. The linkages between resource-based sectors and non-resource-based sectors also appear weak. Another challenge is to tackle

Box 2.1. Exploring the determinants of remittance inflows from the Russian Federation

The Russian Federation is an important host country for migrant workers from other economies in North and Central Asia. During the period 2009-2013, close to $60 billion was sent back home by North and Central Asian migrant workers who are based in this country. However, after half a decade of robust expansion, remittance flows contracted by 2% in 2014. This box contains an examination of the determinants of remittance inflows from the Russian Federation to other North and Central Asian economies, and sets forth the challenges being faced by remittance-dependent countries, such as Armenia, Kyrgyzstan and Tajikistan.

Table A shows the results of a regression analysis, which is based on six countries (Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan and Tajikistan) during the period 2006-2013. Based on quarterly panel data, the estimation methods are feasible generalized least squares for equations 1-4 and the instrumental variables method for equation 5. As a result of the analysis, three major findings are suggested. First, remittances are countercyclical, that is, increasing during an economic slowdown in a home country and decreasing during an economic expansion. Second, higher inflation in a home country contributes to an increase in remittances, possibly in order to smooth spending by migrants' relatives. Third, currency depreciation in a home country against the Russian ruble helps to boost remittance incomes.

Box 2.1. *(continued)*

Figure A below shows the impact on remittance flows of the variation of the economic situations in the Russian Federation and in the home country of the migrant worker in 2014. On the one hand, it can be observed that, in such countries as Georgia, Turkmenistan and Uzbekistan, where changes in the economic situation have not been worse than those recorded in the Russian Federation (see figure A: upper left quadrant), migrant workers sent less money to their home countries.

On the other hand, in Kazakhstan and Kyrgyzstan, migrants remitted more in 2014 than they had previously. In the case of Tajikistan, despite the strong contribution of the economic situation, other factors, such as the appreciation of the Tajikistan somoni against the ruble, and the type of jobs held by migrant workers from this country may also be considered in the explanation of the contraction of remittance inflows in 2014 (see figure B). Thus, a deeper deterioration of the economic situation in the Russian Federation may deeply affect households which rely on remittances for their consumption in countries such as Tajikistan and Kyrgyzstan, with poverty rates (national line) above 37%. To support these households, further reforms aimed at improving the efficiency of public expenditures would be essential, given the limited fiscal space in many recipient countries.

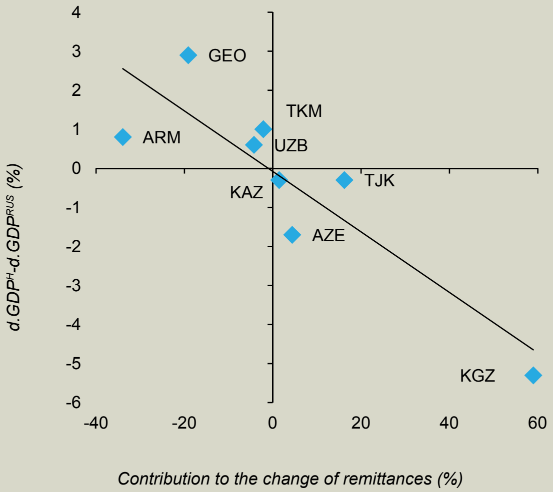
Table A. Empirical analyses of the determinants of remittance flows from the Russian Federation, 2006-2013

Dependent var.: Remittances	EQ1	EQ2	EQ3	EQ4	EQ5
$d.GDP^{H}$-$d.GDP^{RUS}$	-0.002** (-1.99)	-0.002** (-2.30)	-0.003*** (-2.68)	-0.003*** (-2.72)	-0.002* (-1.91)
Exchange rate		0.011*** (7.26)	0.010*** (6.28)	0.010*** (6.30)	0.010*** (6.30)
Inflation [Home]			0.009*** (3.29)	0.008*** (3.12)	0.006* (1.86)
$Interest^{H}$-$Interest^{RUS}$				0.001 (0.55)	-0.001 (-0.43)
Remittances[t-1]					0.314*** (2.43)

Source: Gui-Diby (forthcoming, b).

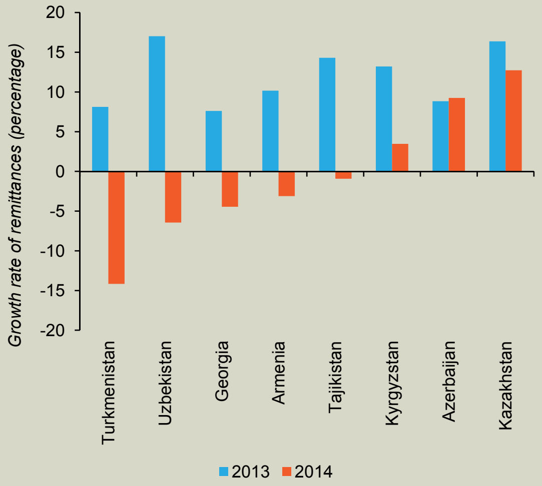
Note: $d.GDP^{H}$ and $d.GDP^{RUS}$ denote the real economic growth rate in a home country and in the Russian Federation, respectively, while $Interest^{H}$ and $Interest^{RUS}$ denote the policy rate in a home country and in the Russian Federation, respectively. The symbols *, **, and *** refer, respectively, to 10%, 5% and 1% significance levels.

Figure A. A scatter plot between economic performance in North and Central Asia and remittance flows in 2014



Source: ESCAP, based on results of equation (4) in table A.
AZE=Azerbaijan, ARM=Armenia, GEO=Georgia, KAZ=Kazakhstan, KGZ=Kyrgyzstan, TJK=Tajikistan, TKM=Turkmenistan and UZB=Uzbekistan.

Figure B. Growth in remittance inflows from the Russian Federation, 2013-2014



Source: Central Bank of Russia.

Note: Data for 2014 is for the first 9 months.

Note: This box was prepared on the basis of Chami and others (2008) and Gui-Diby (forthcoming, b).

vulnerable employment. Close to 20% of the labour force currently works in the agricultural sector, which contributes only 5% of GDP.

2.2. Recent performance, outlook and main challenges

Economic growth in North and Central Asia as a whole slowed to 1.3% in 2014 from 2.1% in 2013 (see figure 2.7). Many economies in the subregion rely on commodity exports, such as oil, gas and metals, as a source of growth, and their economic expansion has been hampered by sluggish global economic recovery and less supportive commodity prices. The contribution of resource-related activities to the overall economic growth declined in many economies in 2014. Moreover, an economic slowdown in Kazakhstan and the Russian Federation adversely affected growth performance in other subregional economies, such as Kyrgyzstan and Tajikistan, through weaker workers' remittance inflows, which had an eventual adverse impact on household spending.

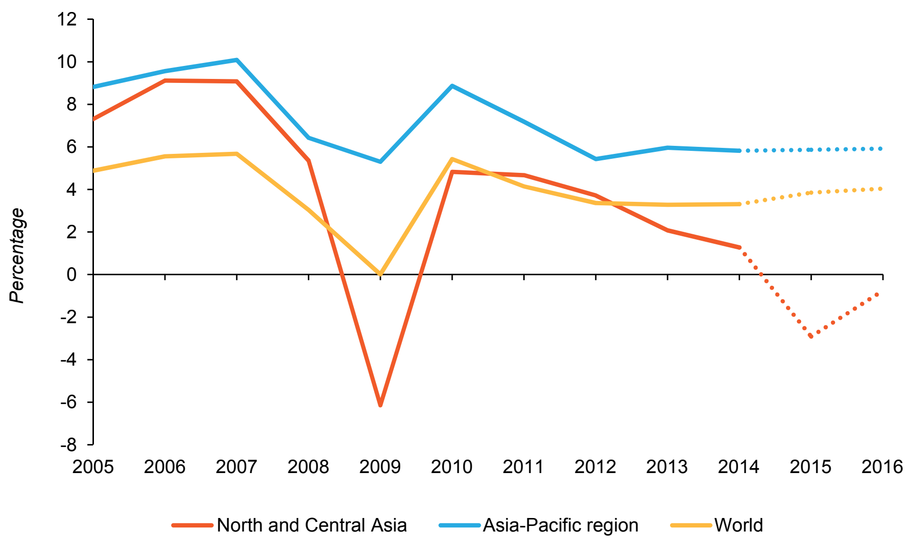
Amid more sluggish economic activity, macroeconomic policy was generally supportive, mainly through an increase in social spending. The outlook for 2015 is expected to deteriorate further, largely due to an expected recession in the Russian Federation. Subregional growth is forecast to contract by 2.9% in 2015. As imported inflation is set to increase because of the depreciation of local currencies, inflationary pressures are expected to increase in all the economies. The subregional inflation rate is projected to be 12.2% in 2015 (see figure 2.8).

Armenia

Economic growth slowed slightly to 3.4% in 2014 from 3.5% in 2013, well below the double-digit growth rates recorded before the start of the global financial crisis in 2008. The mining sector contracted owing to the downward trend of metal commodity prices. Agricultural growth was also sluggish, while the contribution of the construction sector to GDP growth remained negative. Similarly, the contribution of household spending to overall growth decreased due to rising joblessness, a 7% contraction in remittance inflows and a smaller increase in nominal wages. Private consumption was weak despite lower inflation, at 3% in 2014, as the impact of the gas price hike in 2013 started to diminish. The unemployment rate stayed above 15%, while available data on the unemployment trend and job vacancies pointed to a notable mismatch between labour demand and supply.

Growth is projected to soften further to 0.9% in 2015, before rebounding to 2.3% in 2016. The outlook for 2015 is weighed down by likely slower growth in workers' remittances, which account for up to 13% of GDP, and lower private consumption

Figure 2.7. Real GDP growth in North and Central Asia, Asia-Pacific region and the world, 2005-2016



Sources: See figure 2.3 and the website of the Interstate Statistical Committee of the Commonwealth of Independent States. Available from www.cisstat.com.

Note: Estimates and forecasts are as of 31 March 2015.

expenditures amid higher inflation. Armenia's major trading partners, such as Canada and Germany, are also expected to expand at a slower pace, while the Russian Federation is expected to contract. These adverse developments would lower the contribution of net exports to GDP. Nevertheless, growth could benefit from a recent 14% increase in social expenditures on pensions and wages.

Azerbaijan

Maintenance activities on a major platform led to lower output in the oil sector, which accounts for about 45% of GDP. Economic growth thus decelerated to 2.8% in 2014 from 5.8% in 2013. The trade balance deteriorated on the back of lower oil production and exports, as well as less supportive export prices. The non-oil sector performed more favourably, particularly construction activities that benefited from government spending on social housing programmes. Meanwhile, private consumption growth was held back by a slower decrease in unemployment and tightening of consumer lending conditions. Such constrained domestic demand, together with a stable exchange rate, helped to maintain price stability with low inflation of 1.5% in 2014. The monetary policy stance was eased over 2014, with the policy rate having been reduced twice.

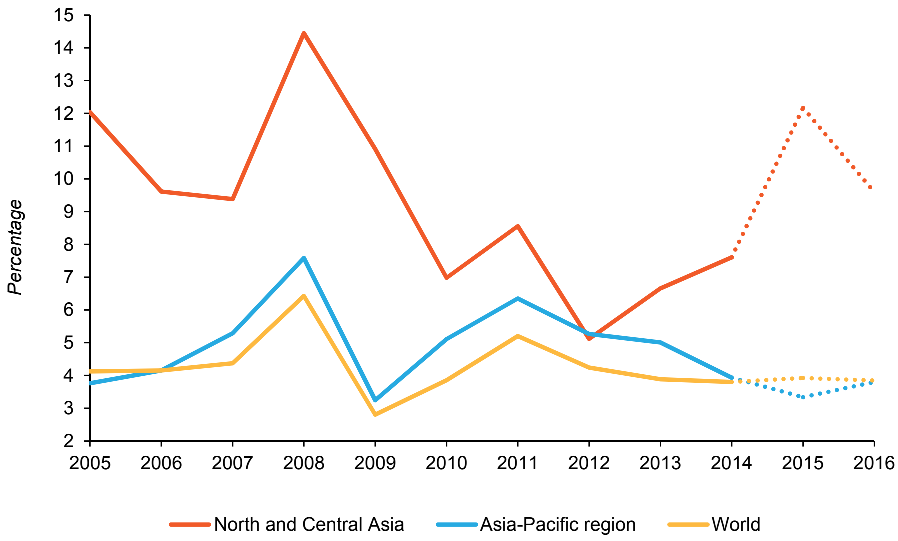
Growth in 2015 is expected to decrease to 2.3% and rebound to 2.5% in 2016. Growth prospects are weighed down by subdued oil prices, higher imported inflation amid currency devaluation and less domestic credits as banks become more reluctant to provide foreign-denominated loans in order to better manage the default risk. Counteracting these adverse factors would be the initiation of operations at a new hydrocarbon project and the ongoing implementation of a public social housing programme throughout the country.

Georgia

Economic growth rebounded from 3.3% in 2013 to 4.7% in 2014, but remained lower than the average growth rate of 6.6% recorded during the period 2010-2012. Lower real interest rates and improved business confidence drove private consumption and investment, which was also reflected in buoyant imports. Ongoing public infrastructure projects supported the construction sector, while the manufacturing and transport sectors also advanced well. Revived domestic demand helped to turn deflation in 2012/13 to inflation of 3.1% in 2014. Nonetheless, inflation remained below the official short-term target of 6% and is expected to remain below this target in 2015.

Steady growth of 4.5-4.8% is projected for 2015/16. Private investments would benefit from the Government's support programmes aimed at improving the business environment and strengthening the linkages between multinational

Figure 2.8. Inflation in North and Central Asia, Asia-Pacific region and the world, 2005-2016



Sources: ESCAP, based on national sources and CEIC Data. Available from www.ceicdata.com.

Note: Data reflect the changes in the consumer price index. Estimates and forecasts are as of 31 March 2015.

companies and local firms. The key headwinds are fragile economic conditions in the European Union and geopolitical tensions in major trading partners, such as Armenia, Azerbaijan and the Russian Federation. Fiscal support could be modest, given the new fiscal rules announced in 2014 that cap government spending and public debt at 30% and 60% of GDP respectively.

Kazakhstan

Growth reached a multi-year low rate of 4.3% in 2014, partly attributable to lower oil production. Non-oil sectors, such as trade, transport and communications, expanded more strongly. Private consumption was held back by higher inflation, which reached 6.7% in 2014, following a 20% currency devaluation announced in 2013. The Government increased spending on wages and social benefits by about 10% to cope with the rising cost of living. On external accounts, the weaker currency pushed up import prices, which together with fragile investor confidence, led to lower imports of investment goods and FDI inflows. To attract more foreign investment, the Government announced an incentive package, including tax exemptions and subsidies on capital investment, to support large-scale investment projects in priority sectors.

Growth is expected to soften further to 1.5% in 2015 owing to lower oil prices and exports. In 2016, recovery at the pace of 2.9% is projected. The Government announced a three-year stimulus package that will provide $3 billion per year for infrastructure development and the construction of schools and social houses. Agro-industry will be provided with support in the form of subsidies on capital expenses. The Government also set aside $2.8 billion to capitalize its problem loan fund and other schemes to maintain financial market liquidity and financial access by small and medium-sized enterprises. A key downside risk is a potential devaluation of the domestic currency against the United States dollar, given the weakening of the Russian ruble that is part of Kazakhstan's basket of currencies.

Kyrgyzstan

The economy expanded at the modest rate of 3.6% in 2014 compared with the high base of 10.5% in 2013. Growth performance over the last few years has been quite volatile, with mild contractions in 2010 and 2012, which were followed by strong recoveries. The volatility was driven mainly by fluctuations in mining output. As with other small, oil-importing economies in the subregion, weak remittance inflows from the Russian Federation constrained consumer spending. Households' purchasing power was also eroded by rising inflation in recent years, which reached 7.5% in 2014. A large share of staple food items consumed in the country is imported, so a currency depreciation of about 9%, along with the low level of domestic food reserves, pushed up overall inflation. Inflation sped up despite a tighter monetary policy stance, which saw the policy rate increasing from 4.1% in January 2014 to 10.5% at year-end. To strengthen the transmission mechanism of monetary policy, the main monetary policy tool has been changed from monetary base management to discount rate adjustment.

A lower growth rate of 2% is expected for 2015. Workers' remittances, which constitute a large share of GDP and are the main source of income for many households, are set to decrease. Exports would be weighed down by the expected slight decline in gold prices. Meanwhile, monetary policy effectiveness could be limited due to a high degree of dollarization in the economy, which weakens the interest rate channel. The inflation rate is expected to increase further to 10.7% in 2015.

Russian Federation

Geopolitical tensions, international sanctions that limit access to foreign funds and high nominal interest rates pushed economic growth in 2014 down to only 0.6%. Growth has indeed exhibited a downward trend since 2012 on the back of weak domestic investment, partly because large infrastructure projects have already been completed. The recent geopolitical developments have dented business sentiments, resulting in the scaling back of investment plans. Amid high levels of economic uncertainty, FDI plunged by 50% in 2014, while total fixed investment also contracted. Similarly, growth in household spending slowed, partly because banks became more reluctant to provide credit despite wider interest rate spreads. Defaults in consumer loans have increased, while household debt surpassed the pre-crisis level and reached 22% of GDP.

Substantial capital outflows widened the capital account deficit to 7.8% of GDP in the first half of

2014 from 2.1% of GDP for the entire year in 2013. As a result, the domestic currency depreciated by about 65%. Although the weaker currency helped improve the trade balance through the fall-off in imports, it pushed up import prices and led to a three-year high inflation rate of 7.8% in 2014. This situation significantly dampens the purchasing power of households.

To support companies affected by international sanctions, the Government has set up a bailout fund that is financed by savings from a temporary suspension in State pension contributions and financial resources from sovereign wealth funds. This included a transfer of $6.6 billion from the National Welfare Fund to two major commercial banks to boost their liquidity, and the establishment of the Loan Guarantee Agency with capital of 50 billion rubles obtained from sovereign funds to support small and medium-sized enterprises. Although the use of public funds to support troubled businesses may help anchor market confidence in the near term, this could potentially crowd out investment in projects with higher economic and social returns. Meanwhile, meeting the short-term fiscal targets, such as reducing the non-oil fiscal deficit and replenishing the country's Reserve Fund, is challenging during a period of economic uncertainty due to unplanned expenditure and lower-than-expected tax revenues and energy prices.

On the monetary policy side, the central bank increased the policy rate to 17% in order to curb inflationary pressures; it started implementing a free-floating exchange rate system in November 2014. The monetary policy framework is also shifting towards an inflation-targeting system.

The near-term outlook is dim. The economy is forecast to contract by 4% in 2015 and 1.6% in 2016. Continued geopolitical instability, uncertainty regarding the extent and timing of international sanctions and lower global energy prices would dampen exports and government revenue, thus constraining growth. As the impact of the weaker exchange rate on prices tends to last for some time, the inflation rate is expected to increase by more than five percentage points to 13% in 2015.

Tajikistan

Growth slowed to 6.7% in 2014 from a stable expansion rate of about 7.4% in the preceding three years. Amid an economic slowdown in the Russian Federation, remittance inflows, which represent almost 50% of GDP, declined by 1% in 2014. Weak capital inflows led to currency depreciation, which raised import prices significantly for such essential food items as wheat and sugar. Subdued remittance incomes and higher inflation, together with a tight monetary policy stance, resulted in a contraction of household spending. Meanwhile, industrial production volume shrank by 1.8% owing to weak orders for aluminium. The aluminium sector exhibits low productivity due to the utilization of a production process that is not very energy efficient.

In an effort to maintain macroeconomic stability, an intervention in the foreign exchange market resulted in international reserves dropping by 47%, from $349 million in January 2014 to $184 million by the end of the year. On the fiscal side, although the Government has increased spending on social protection and education, the deficit dropped to 1% of GDP in 2014 due to improved revenue collection. Tax administration is made more efficient through electronic payment of income tax, among other measures.

Growth outlook is expected to be relatively subdued, at 4% in 2015 and 4.8% in 2016. An expected economic recession in the Russian Federation would dampen workers' remittances and household spending. Moreover, exports of aluminium would be held back by a projected moderate decline in aluminium prices and production that is energy-intensive. Inflation is expected to rise further in 2015, as the weak domestic currency would continue to drive up import prices.

Turkmenistan

Output growth remained buoyant at 10.3% in 2014, which is the fourth consecutive year when growth rates were at double-digit levels. Public and private investments propelled activities in the hydrocarbon and construction sectors. Natural gas exports, which account for more than half of total exports, increased on the back of higher output at a major gas field and the construction of new processing facilities. However, the steady expansion of the economy pushed up the inflation rate to 11% in 2014 from 9% in 2013.

Growth is projected to remain high at 9.5% in 2015 and 9.2% in 2016. New hydrocarbon infrastructure and government spending would support rapid growth. The Government announced an increase in public wages, pensions and student grants by 10%, which became effective in January 2015. Despite the positive outlook, the main headwind is projected high inflation that is a result of a currency devaluation of about 20% in December 2014 and the increase in subsidized prices of petrol and flour. Another adverse factor is a possible decline in hydrocarbon commodity prices.

Uzbekistan

Economic growth remained strong at 8.1% in 2014. Agricultural output increased significantly, although industrial output was hampered by lower gold prices and an economic slowdown in Kazakhstan and the Russian Federation. From the demand side, government spending largely drove the economy. Despite the 20% increase in salaries and pensions, the contribution of private consumption to GDP softened due to a 6% decrease in remittance inflows from the Russian Federation in 2014. The high inflation rate, at 11.7% in 2014, on the back of strong domestic demand and currency depreciation also constrained consumer spending.

Growth is anticipated to remain high at between 7.1% and 7.2% over 2015/16. Domestic factors will continue to support growth, as merchandise exports and remittance inflows are likely to be weak. The Russian Federation recently announced its plan to reduce gas imports from Uzbekistan. Similarly, global prices of gold, cotton and hydrocarbon products are expected to remain subdued.

2.3. Selected medium-term policy challenges

As is evident from the above discussion, economic activities in North and Central Asia are typically concentrated either on commodity exports or workers' remittances. Such economic concentration makes economies in the subregion highly vulnerable to external shocks and macro-economic conditions in the Russian Federation. This highlights the need to diversify sources of economic growth. Economic diversification can be achieved through the production of goods with higher value added within the same industries and participating more in the global value chain (vertical diversification), or by developing new sectors and/or products (horizontal diversification). For both types of diversification, a dynamic and entrepreneurial private sector is required. Governments could play an important role in spurring entrepreneurship and innovation, and private investments in general.

To stimulate innovation and boost private investment, the Governments of countries in the subregion could utilize funds from natural resource rents in four areas: (a) building a creative labour force through an appropriate educational system; (b) establishing research platforms or connections which facilitate access to modern technologies; (c) removing binding obstacles to investments; and (d) supporting entrepreneurs (World Bank, 2010). Specific policy options could include training programmes to enhance business management skills, a government scheme to adapt foreign technologies to reduce high fixed cost of conducting basic scientific research by private firms and the promotion of public-private partnerships in carrying out research and development activities.

In this regard, ESCAP analysis based on firm-level surveys shows that the availability of a labour force with tertiary education, job training and research and development expenditures could significantly foster entrepreneurship and innovation in North and Central Asian countries (see annex I and annex II for more details). The analysis also shows that insufficient competition in domestic markets is holding back innovation efforts in the subregion. Meanwhile, the positive relationship between the exporting share of a firm and its extent of innovation – typically found in other studies – appears absent in the context of North and Central Asia. This underlines the dominance of resource-based, low-complexity exports in the subregion and the need to attract FDI that is not in the natural resource sector.

An effort to attract more FDI into North and Central Asia has been focused on addressing investment constraints. For example, Kazakhstan and Kyrgyzstan are establishing one-stop service windows and streamlining the tax payment process. The countries also introduced trade facilitation measures and constructed or upgraded transport infrastructure to reduce international trading costs. In Georgia, under the programme "Produce in Georgia", the Government supports investors through the provision of land, funds and advice. However, for the subregion as a whole, more policy actions are still required to enforce contracts and resolve bankruptcy cases.

With regard to firms' access to finance, such countries as Kazakhstan and the Russian

Federation provided financial support through subsidies, preferential loans and tax incentives. Similarly, in Georgia, writing-off overdue tax arrears and postponing tax payment by small businesses are considered as means to promote investment. To strengthen the backward linkages between multinational companies and local firms, the Government of Georgia also exempts local producers which are suppliers of multinationals from having to pay value-added tax. Despite the progress made, access to credit is generally constrained by high borrowing costs and strict requirements and regulations on collateral.

Natural resource endowments can also be the plinth for the diversification of an economy, provided that appropriate policies are designed to build the capacity of human resources, to establish an appropriate business environment for private entrepreneurs and to finance innovative initiatives.

3. THE PACIFIC

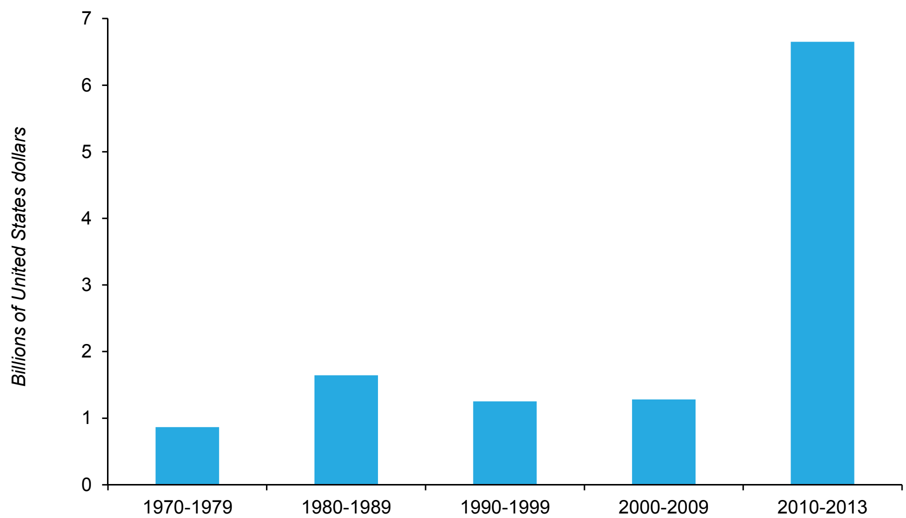
3.1. Key economic and social themes

Pacific island developing economies are typically small in terms of population and land area and have limited resources. Such conditions make them especially vulnerable to external shocks, including climate change-related developments. The reliance on overseas development assistance and workers' remittances is high. On the other hand, the role of the private sector in supporting the economy is generally limited, mainly underpinned by the lack of public infrastructure, shortage of a skilled workforce and high logistics and shipping costs. The public sector is thus dominant and is the main source of employment in many economies in the subregion. These structural impediments are emphasized in the Small Island Developing States Accelerated Modalities of Action, or Samoa Pathway, discussed during the third International Conference on Small Island Developing States in September 2014.[8]

A large proportion of the population in Pacific island developing countries live in rural areas and rely heavily on the agricultural sector, mainly for subsistence living. However, the share of agriculture in GDP, which ranged from 3% in Nauru to 30% in the Federated States of Micronesia in 2012, has declined in many of the economies in the past two decades. Lack of technical skills, poor agricultural extension services and limited access to finance mainly explain the decline. For most economies, the share of the services sector in GDP is much higher, ranging from 31% in Nauru to 86% in Cook Islands.

Pacific island developing countries face various vulnerabilities. The rise in sea level and other expected adverse impacts of climate change continue to pose significant risks to countries' efforts to achieve sustainable development. For many countries, such vulnerabilities represent the gravest of threats to their survival and viability, including through the loss of territory. Many of these economies are frequently affected by natural disasters, causing major havoc and destruction of economic activities, including essential infra-structure, such as roads, bridges and buildings (see figure 2.9). Past reconstruction activities often

Figure 2.9. Total yearly economic losses from natural disasters in the Pacific, 1970-2013



Source: ESCAP (2015b).

relied significantly on donor assistance owing to the magnitude of the damage.

Many countries struggle to deliver basic public services, particularly in rural and remote areas, including outer islands. A large proportion of Pacific islanders lack access to safe drinking water, sanitation, reliable sources of energy, education and health care. As a result, poverty remains relatively high in most countries. The proportion of people falling below the poverty line ranges from 13% in Vanuatu to 39% in Papua New Guinea. While the incidence of poverty has declined in Fiji and Vanuatu over the past decade, poverty has increased in Samoa, Tonga and Tuvalu and remained stagnant in other Pacific island developing economies. There are also wide disparities in poverty across groups within a country. For example, in Fiji and Vanuatu, where the overall level of poverty decreased, poverty in rural areas increased in Fiji and poverty in urban areas rose in Vanuatu. Available data also suggest that the poverty rate among households with three or more children is significantly higher than the national averages.

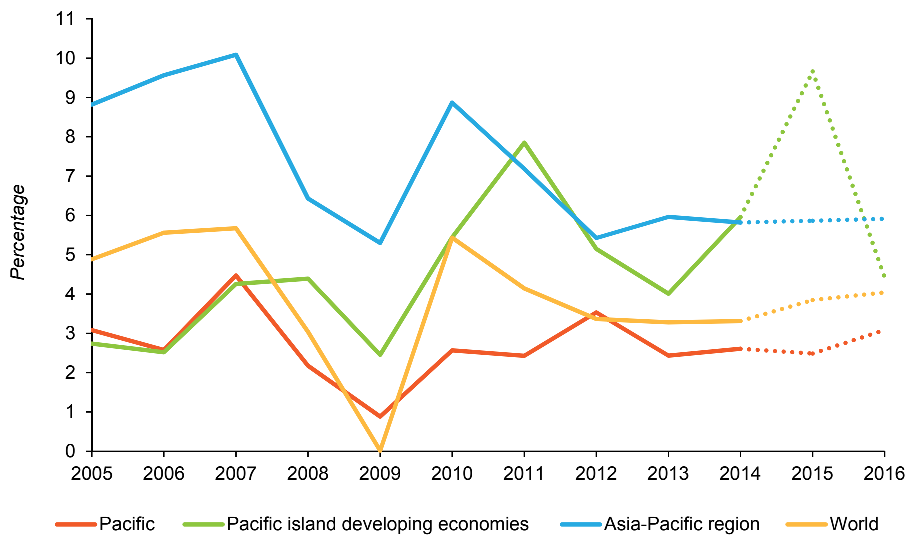
Pacific island developing economies continued to record low and uneven economic growth rates in recent years. During the period 2008-2013, only Nauru, Papua New Guinea and Tuvalu enjoyed annual GDP per capita growth that was higher than 3%. Indeed GDP per capita decreased in Kiribati and Palau. The subregion's ability to sustain rapid, sustained economic growth has been hampered by various factors. On the domestic front, the lack of adequate transport, energy and information and communication technology infrastructure networks and limited human and institutional capacity are key growth constraints. On the external front, ongoing adverse impacts from global economic crises and declining foreign direct investment and foreign aid flows have held back growth in the subregion.

Faster economic growth is needed in order to generate more jobs. In Tonga, the 2011 population census revealed that only 52% of the working-age population was economically active. In Kiribati, more than 30% of the labour force was unemployed, while almost 60% of those who work in Vanuatu were still engaged in subsistence activities.

3.2. Recent performance, outlook and main challenges

Pacific island developing economies as a whole grew by 6% in 2014, a three-year high (see figure 2.10). With the clear exception of Solomon Islands, the economy of which contracted due to the devastating impact of a cyclone, the expansion among those economies was generally broad-based but remained highly uneven across individual economies. Growth was driven particularly by mineral resource production in Papua New Guinea,

Figure 2.10. Real GDP growth in the Pacific, Asia-Pacific region and the world, 2005-2016



Sources: See figure 2.3.

Note: Estimates and forecasts are as of 31 March 2015.

the GDP of which accounts for close to 60% of total output of the Pacific island developing economies as a whole.

Most of those economies continued to register current account deficits, primarily due to weak production and export capacity and reliance on the import of essential goods. Frequent natural disasters disrupt economic growth and macroeconomic stability, giving them limited room for making valuable macroeconomic policy responses.

Pacific island developing economies as a whole are set to record a robust expansion of 9.7% in 2015, underpinned partly by the 15% projected growth rate in Papua New Guinea, which would benefit from mineral exports. The expected steady economic expansion in Australia and New Zealand and continued post-cyclone reconstruction efforts in some economies are some of the key growth drivers. Lower energy import bills would help to keep inflation in 2015 at relatively low levels (see figure 2.11). Lower oil prices would also support household incomes in developed economies, which could translate into higher tourist arrivals in the subregion. On the downside, subdued international prices for agricultural products and primary commodities could constrain commodity shipments from the subregion in 2015.

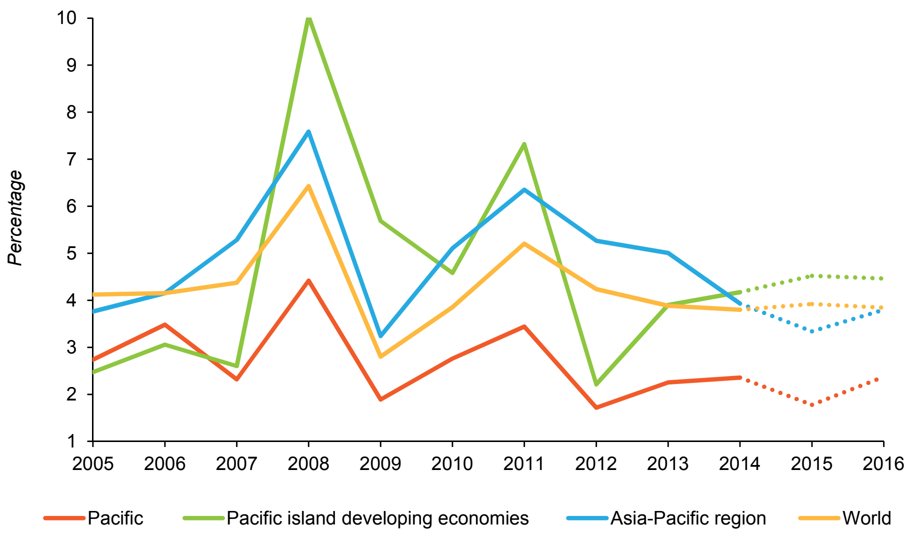
Pacific island developing economies

Fiji

Output growth moderated to a still strong 4.2% in 2014 over the rate of 4.6% in 2013. Growth performance in these two years was more favourable than the average of 1.4% in the preceding five years. Growth in 2014 was largely broad-based. Both public and private investment buoyed the construction sector. Sugar production drove manufacturing activity, which benefited from improved mill efficiency and cane supply. Higher workers' remittances, eased consumer credit conditions and low inflation supported consumer spending and retail trade. Robust tourist arrivals, which increased by 4.2% in the first three quarters of 2014 owing in part to more frequent air services, also supported household spending. Meanwhile, a pickup in growth in recent years has boosted import demand, which pushed up the current account deficit to 8.1% of GDP in 2014. Nonetheless, international reserves remained at comfortable levels due to a surplus in the financial and capital accounts.

Growth is forecast to be slightly lower at 4% in 2015. Ongoing public and private investment, greater political stability following the election in September 2014 and strong sugar and tourism sectors would be among the key growth enablers. A new bill that requires access to free education and health

Figure 2.11. Inflation in the Pacific, Asia-Pacific region and the world, 2005-2016



Sources: ESCAP, based on national sources and CEIC Data. Available from www.ceicdata.com.

Note: Data reflect the changes in the consumer price index. Estimates and forecasts are as of 31 March 2015.

care and adequate public infrastructure will further increase government spending, although the fiscal deficit should remain manageable, benefiting from improved tax compliance.

To address the still high poverty rate of 31% in 2009, the Government expanded the coverage ofits assistance programme and introduced a social pension scheme for elderly groups. New draft labour legislation is also aimed at strengthening social protection, while an inclusive insurance scheme is designed to expand insurance services to low-income earners and workers in the informal sector.

Papua New Guinea

Output growth accelerated to 8.4% in 2014 from 5.1% in 2013, due to early commencement of liquefied natural gas (LNG) production. Favourable production of gold and copra also propelled growth in the second half of the year. Beyond the mining sector, output grew by only 1.4%, as spillover from the now completed LNG construction project weakened. For example, the construction sector contracted by 6.4% in 2014. The project's completion also led to lower import demand, which together with increased commodity exports, helped trim the current account deficit to 3.7% of GDP in 2014.[9] Meanwhile, the inflation rate stepped up to 6.6% in 2014 due to a weaker currency, higher prices for housing and seasonal items. The pace is, however, still in line with the government estimate of 6.5% due to lower-than-expected global commodity prices.

Growth in 2015 is expected to surge to 15%, the fastest pace in Asia and the Pacific, underpinned by a full year of production and export of LNG and an expected rebound in the non-resource sectors, such as the agricultural and fishery sectors. Growth is projected to return to a steadier pace of 5% in 2016. Mining activities will continue to drive the economy in the near term. Fuel, gold and copper together account for about two thirds of total exports. The key downside risk is lower-than-expected international commodity prices.

The immediate policy challenge is to manage windfall commodity revenue to achieve more inclusive growth. The early production of LNG, along with mining and petroleum taxes, boosted government revenue growth by about 24% in 2014. The Government should ensure that spending is beneficial to the productive capacity of the economy and supports the lives of rural people who comprise the majority of the population. Although the official public debt projection is slightly above the stipulated limit of 35% of GDP, the risk of debt default is considered low given that a large share of the public debt is domestic and the external component is on concessional terms.

Samoa

Economic growth in 2014 rebounded to 1.9% from a contraction of 1.1% in 2013 after tropical cyclone Evan caused extensive damage in many parts of the country in late 2012. Improved growth in 2014 was supported mainly by the donor-financed reconstruction programme and economic activity relating to the hosting of the Third International Conference on Small Island Developing States, which was held in Apia in September 2014. However, workers' remittances, which account for about one fifth of GDP, slowed. Meanwhile, despite a 3% hike in public sector wages, the prices for goods and services dropped further by 0.4% in 2014 from a marginal decline in 2013. Lower prices are attributable to improved domestic supply conditions that resulted in lower food prices, subdued global commodity prices and a stable exchange rate.

Growth is projected to gain stronger momentum at 2.5% in 2015. Some of key growth drivers are further post-cyclone infrastructure upgrades, business and tourism activities relating to the hosting of the 2015 Commonwealth Youth Games, construction of new hotels and the expected revival in remittance incomes. In looking forward, medium-term growth will be constrained by a narrow economic base. Close to 40% of the labour force works in the agricultural sector, which is largely on a subsistence basis. In this regard, government policies to reinvigorate agricultural production and boost tourism are critical.

Solomon Islands

The economy contracted by 0.2% in 2014 from a 2.9% growth rate in 2013. Cyclone Ita lashed parts of the country in April and caused extensive damage to major infrastructure and the agricultural, trade and transport sectors. The flooding caused by the storm halted production at a major gold mine that had contributed about one fifth of GDP. The cyclone depressed the domestic supply of fruits and vegetables, thus pushing up the annual inflation rate to 6%, the second highest rate among

Pacific island developing economies. Suspended gold exports and increased import demand for reconstruction widened the current account deficit to 9.5% of GDP. The fiscal deficit was also larger than expected due to the reconstruction costs and below-target government revenue.

The economy is expected to resume expansion and achieve a growth rate of 3% in 2015. A rebound in agricultural output and continued reconstruction work on roads and bridges would support the economic recovery. The prospects are also conditional on the timing of recommencement of operations at the gold mine. The logging industry has tended to stagnate, but the impact will be offset in part by rising investment in the telecommunications sector and increased demand for non-gold commodity exports, such as palm oil, copra and tuna.

Long-term issues in the mining sector pose a key risk for the economy. Growth performance in recent years has been driven mainly by log exports but this trended downward even before the flooding due to flat forestry output. This situation has dampened government revenue, and there is concern over the sustainability of natural forest logging. Despite attempts to diversify the economic base, the economy remains concentrated on a few commodities. Expanding various infrastructure links and developing such sectors as diving and eco-tourism would be important to unleash other growth drivers. There is also a need to expand opportunities for subsistence workers to engage in market activities.

Vanuatu

Economic expansion trended upward in recent years and reached 3.6% in 2014. Major public infrastructure projects boosted construction activity and generated more employment opportunities. This helped to support private consumption even though tourist arrivals declined. Stronger economic growth was also underpinned by higher public consumption that benefited higher value-added tax revenue and import duties. Meanwhile, inflation dipped to 0.3% in 2014, compared with the average of 1.2% in the preceding three years. Lower inflation was due mainly to excess production capacity and a decline in fuel prices.

The economy is projected to contract by 0.5% in 2015 following massive destruction to agriculture and infrastructure caused by cyclone Pam in March 2015. Inflation is expected to increase to 4% in 2015 as the cyclone disrupted the supply of food items. The risk to medium-term growth are the delays on infrastructure projects due to capacity constraints.

Smaller Pacific island developing economies

The economy of **Cook Islands** faced another year of contraction, at the rate of 1.2% in 2014 from a decline of 1.7% in 2013. The overall visitor arrivals grew by a modest 1.6%, although growth in the number of visitors from Asia surged by more than 34%. The economic contraction was also underpinned by a decline in infrastructure spending, while expansion of private investment and consumption also moderated. Growth is projected to rebound to 2.1% in 2015 on the back of ongoing infrastructure developments.

In **Kiribati**, economic growth reached 3% in 2014, relative to the growth performance between 2.4% and 3.4% over the period 2011-2013. Donor-funded public infrastructure programmes, such as a major road project, and higher fishery output boosted consumer confidence and spending. After two years of deflation, inflation stood at 2.6% in 2014 on increased demand from infrastructure spending and the weakening of the Australian dollar, which is pegged to the local currency. Looking forward, output growth in 2015 is projected to slow to 1.5%. Public works would continue to support growth. Volatile primary commodity prices present a key downside risk.

In **Marshall Islands**, despite the recovery in fishery output, the completion of donor-funded infrastructure upgrades led to the growth slowdown of 0.5% in 2014 from the average of 3.8% over 2012/13. Growth is projected to increase to 3.5% in 2015 due mainly to work on infrastructure projects.

The economy of the **Federated States of Micronesia** contracted again at 3.4% in 2014 from a 4% contraction in 2013. Despite some recovery in visitor arrivals and fishery output, inadequate private investment, sluggish business activities and a slowdown in major public infrastructure projects hold back the economy.

In **Nauru**, output growth reached 10% in 2014, the highest rate in a decade. The reopening in 2012 of the Australian Regional Processing Centre for asylum seekers, the second largest employer after the Government, and subsequent expansion of job opportunities boosted domestic demand. Higher consumption was also supported by substantial payments to landowners from final liquidation of the Nauru Phosphate Royalties Trust. Activities relating to the operations of the Regional Processing Centre, such as construction, are expected to support a growth rate of 8% in 2015. There is a need to manage windfall revenue, for example from the secondary mining of phosphate, to help sustain government services over the medium term.

In **Palau**, after a mild economic decline in 2013, the economy recovered strongly at 6.9% in 2014 due to robust tourism revenue and increased construction activities. Tourist arrivals rose, as the second airline started operating chartered flights from Hong Kong, China in September. As a result, the number of tourists from China increased, and in late 2014 China became the largest originating country for visitors to Palau. The outlook for 2015 is optimistic, with growth projected to reach 8% on the back of higher numbers of tourist arrivals and an increase in infrastructure spending.

Tonga was affected by a major cyclone in January 2014, which caused severe damage to the economy. Nonetheless, reconstruction activities, financed by foreign aid and revenue generated by higher numbers of tourists, helped push up economic growth in 2014 to 2.1%, from output contraction of 2.7% in 2012/13. A recovery in agricultural output supported household incomes amid slowing worker remittances, which accounted for more than a quarter of GDP. Tax revenues increased in line with the more rapid economic growth, resulting in a fiscal surplus of 1.7% of GDP in 2014. Stronger growth momentum of 2.4% is expected in 2015, mainly due to a more favourable tourism sector, the preparations for the 2019 Pacific Games, and infrastructure projects on roads and an airport, which are financed by development partners.

Output growth in **Tuvalu** trended up to 2% in 2014, largely underpinned by donor-funded construction work on upgrading an airport and increased retail activity. The public sector continues to be the major source of domestic employment, while job opportunities for seafarers and seasonal worker programmes in Australia and New Zealand have provided the country with remittance income. Growth is projected to remain stable at 2% in 2015, supported mainly by an expected strong fishery sector.

Australia and New Zealand

Australia

The economy expanded at a steady pace of 2.5% in 2014. Commodity exports supported economic growth in the first half of the year but shipments weakened afterwards owing to lower export prices of iron ore and coal. Iron ore accounts for about a quarter of total exports and 4% of GDP. Meanwhile, mining investments, which had driven the economy in recent years, shrank in 2014 as the mining sector shifted to the production stage. Dwelling investments, on the other hand, remained robust. Retail sales rebounded in the later part of the year buoyed by savings from lower retail energy prices, although household consumption has been held back by subdued wage and employment growth. The unemployment rate reached 6.4% in January 2015.

Overall inflation for 2014 stood at 2.5%, virtually unchanged from the rate in 2013. The weakening of the Australian dollar added inflationary pressure in the first half of the year. Price rises softened in the second half amid falling oil prices and the removal of the carbon tax. Inflation dipped to 1.7% in the final quarter of 2014, which is below the central bank's target of 2-3%.

Growth for 2015 is projected to moderate slightly to 2.3%. Exports of liquefied natural gas would benefit from the weaker exchange rate. A 25 basis points cut in the policy interest rate in February 2015, the first cut since mid-2013, should help relieve household debt burden that has been on the upward trend since 2013. Lower borrowing costs would also benefit the already strong investment in the property sector, which warrants close monitoring of house prices. Meanwhile, mining investment is expected to fall, as large projects are completed while new pipeline projects may be deferred given the recent decline in commodity prices. Given the relatively tepid domestic demand, the pace of fiscal consolidation is set to be slower. The government aims to achieve the fiscal surplus by 2019/20. The continued rolling out of infrastructure investment under the Infrastructure Growth Package that is worth over $125 billion would help sustain economic activity.

New Zealand

Economic growth rose to 3% in 2014, the highest rate since 2008. The expansion was underpinned by robust household spending amid low interest rates and increased residential investment owing to high net immigration. Despite strong economic growth, inflation in 2014 remained low at 1.2% due to the fall in global oil prices during the latter part of the year.

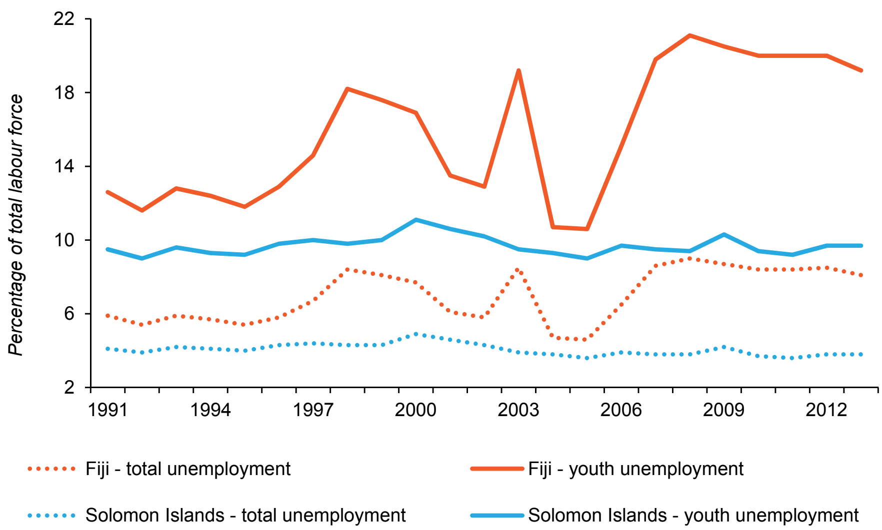
Growth in 2015 is projected to be stable at 3% before edging up to 3.5% in 2016. Post-earthquake reconstruction would continue to boost housing investment in the next few years. Consumer spending would be supported by low inflation and improvement in employment conditions as well as favourable wealth effect from rising house prices. On the downside, government consumption is expected to rise only modestly, constrained by fiscal consolidation efforts. Export growth would likely be slow as a result of weaker orders from major trading partners, such as Australia and China. Increased global supply of milk and dairy products has depressed international prices of these products, which are New Zealand's most important export items.

3.3. Selected medium-term policy challenges

As highlighted above, Pacific island developing economies face various structural impediments to economic growth. These include, for example, a small and narrow economic base and vulnerability to natural disasters and the effects of climate change. Given the limited fiscal space and extensive damage that natural disasters often cause, large public infrastructure projects and post-disaster reconstruction activities typically rely on foreign aid. For example, in Samoa the required spending to rebuild infrastructure after the cyclone of early 2014 kept the fiscal deficit at close to 5% of GDP for the whole year, even after taking into account external grants that were equivalent to 14% of GDP.

In this context, strengthening private sector development would help to address some of the subregion's growth constraints. A more vibrant business sector could expand the currently narrow economic base and support government revenue that could then be spent to reduce notable gaps on service delivery in rural areas and outer islands. An energized private sector would also create more jobs, thus relieving the problem of high youth unemployment and reducing the dominant role of the public sector as a job provider (see figure 2.12). At the household level, jobs in the formal sector would strengthen income security and reduce households' reliance on volatile remittance incomes.

Figure 2.12. Total and youth unemployment in Fiji and Solomon Islands, 1991-2013



Sources: ILO, Key Indicators of the Labour Market and World Bank, 8th ed., World Development Indicators database.

To promote private sector development, countries in the subregion have focused on ensuring an enabling environment for business operations. Papua New Guinea has commenced reviews on market competition and financial sector services. The central bank also introduced a new payment system to improve liquidity management, which includes real-time settlement of high-value payments and electronic submission of cheque imaging. Meanwhile, Fiji reduced the profit tax rate, introduced a plan for capital market development and implemented Internet banking practices. Vanuatu set up a private credit bureau that helped facilitate access to credit and introduced a computerized land registry system. A private credit bureau was also established in Tonga. Finally, Palau reduced customs clearance time and eased access to finance by, among other things, establishing a centralized collateral registry and allowing the use of future assets as collateral.

Despite some progress made on improving the business environment, the subregion still compares rather unfavourably with other economies in the world. The World Bank's Doing Business database, which ranked economies in terms of ease of doing business, placed Samoa, the best performer among Pacific island developing countries covered in the study, at 67th out of 189 economies. Kiribati, Marshall Islands, the Federated States of Micronesia, Palua and Papua New Guinea are ranked between 113th and 145th.

As part of reforms to promote the private sector, countries also sought to promote public-private partnerships, improve the operational efficiency of State-owned enterprises and enhance public financial management. Fiji introduced reforms of public enterprises and financial management that are aimed at strengthening the accountability and transparency of government agencies and ensuring prudent management of public resources. For example, the Government outsourced road and bridge planning, construction and maintenance work in order to raise the efficiency of public service delivery. In Papua New Guinea, public sector and governance reforms are also moving forward in 2015, such as the planned amalgamation of government units with duplicate functions. Its parliament also passed public-private partnership legislation in August 2014 that will facilitate the creation of agencies responsible for coordinating, implementing and overseeing such partnership projects. Kiribati's privatization plan, particularly in the telecommunications sector, also advanced.

Economies in the subregion have comparative advantages in certain niche, higher value-added industries, such as sustainable tourism and fishery activities. Fiji, for example, endorsed in mid-2014 a green growth framework that will incorporate environmentally sustainable initiatives into the country's future development strategies. To move away from producing and exporting primary commodities, the Government may also provide micro-level schemes to boost entrepreneurship and innovation in order to increase the country's competitiveness. To unlock potential growth, Governments of countries in the subregion could also push forward land reform to make use of idle land and financial sector reforms to promote access to finance and thus the development of small and medium-sized enterprises. Box 2.2 is focused on domestic policies to enhance financial inclusion in the Pacific.

4. SOUTH AND SOUTH-WEST ASIA

4.1. Key economic and social themes

Economies in the South and South-West Asian subregion are largely consumption-driven. The share of consumption expenditure, in which a large part is household consumption, ranged from about 70% of GDP in India to more than 90% of GDP in Nepal and Pakistan. The role of exports is thus limited. In India and Turkey, which are better connected to the global economy compared with other subregional peers, the export of goods and services still accounts for only a quarter of GDP. Such economic structures are reflected in a rising share of services in GDP in most countries, while the manufacturing share has been stagnant at below 20%. Owing to the limited role of trade and production networks in South and South-West Asia, subregional output co-movement is limited. Another reason is that, for many countries, economic activities often are concentrated on a few sectors, such as agriculture in Afghanistan and Nepal, garments in Bangladesh, Pakistan and Sri Lanka, hydropower-generation in Bhutan, tourism in Maldives and oil production in the Islamic Republic of Iran.

Despite these limiting features, the commendable economic growth record in the South and South-West Asian subregion has helped to reduce poverty. Within Asia and the Pacific, only East and North-East Asia expanded at a more rapid rate than South and South-West Asia during the period 2000-2014. In line with strong output growth, the poverty rate

Box 2.2. Promoting financial inclusion in the Pacific

Despite good progress made in recent years, access to high-quality and affordable financial services, such as savings, loans, fund transfers and insurance, as well as financial education, appears limited in the Pacific island developing economies. About 6.5 million people, mostly earning low incomes, still lack access to financial services. Poor public infrastructure and sparse populations, situations which lead to high costs for delivering public services, are some of the key barriers to accessing finance.

Government efforts to promote financial access have intensified in recent years. Several economies have set up national agencies to coordinate in-country financial inclusion efforts. For example, Fiji's National Financial Inclusion Taskforce collaborates closely with private and public entities, microfinance institutions, civil society groups and development partners to promote financial inclusion. Papua New Guinea developed a financial inclusion strategy that is designed to reach, by the end of 2015, an additional 1 million low-income residents who do not have their own bank accounts; half of these people will be women. The strategy will be focused on building an enabling regulatory framework that eliminates barriers to financial access and use of financial services to promote innovative technology. Meanwhile, Samoa and Solomon Islands amended their central banking acts to include financial inclusion and financial literacy as core mandates, while financial inclusion units in central banks are common in several other economies.

With regard to financial literacy, major economies in the subregion have prepared national financial competency strategies. Fiji has integrated financial education into the school curriculum from years 1 to 12, which is recognized as a global best practice and is becoming a model for other countries in the Pacific subregion. Cook Islands offers financial literacy classes in partnership with commercial banks, while Solomon Islands is finalizing the expected learning outcomes of financial education. Vanuatu is considering introducing financial education into the national school curriculum, while Papua New Guinea developed financial literacy modules that target rural communities.

Beyond country-level efforts, economies in the subregion and the international development community have also partnered to promote financial access. An example is the Pacific Islands Regional Initiative, in which five central banks in the subregion jointly created a financial inclusion data set for the Pacific. The data set contains, among other things, indicators to measure the growth of mobile financial services, remittance flows and barriers to opening a bank account, as well as indicators to benchmark client protection and financial education across economies. More broadly, the Pacific Financial Inclusion Programme, jointly managed by the United Nations Capital Development Fund and the United Nations Development Programme, is aimed at adding 1 million people in the subregion to the formal financial sector by 2019. Among its activities, the programme provides private companies with grants to create financial services that especially benefit the poor and rural dwellers.

One promising policy direction is to promote financial inclusion through mobile phone-based financial services. The use of such "mobile money" is being piloted in several countries. In Fiji and Samoa, between 90% and 95% of the population have access to a mobile phone. In Papua New Guinea, mobile phone subscriptions jumped from 100,000 to 1.5 million in less than 3 years. Further development in this area would require strong partnerships among mobile network operators, financial services providers and retailers.

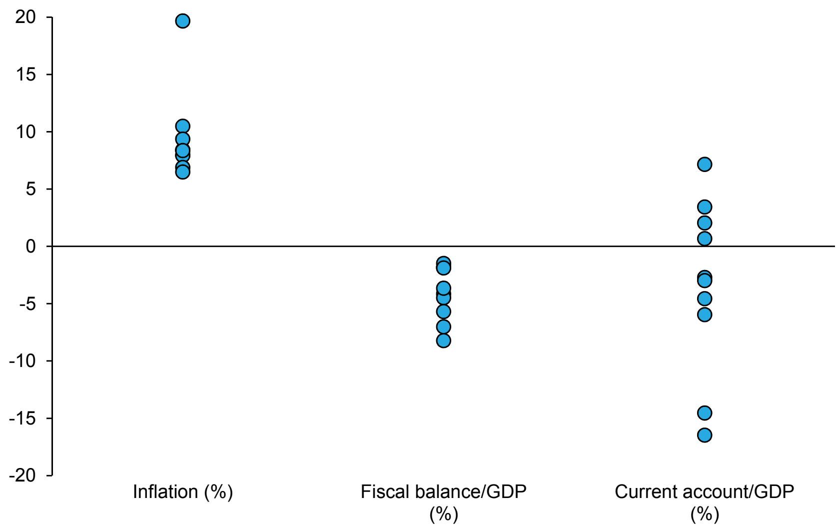
Note: This box is based on contributions from the Alliance for Financial Inclusion's Pacific Islands Regional Initiative and UNDP Pacific Financial Inclusion Programme.

decreased from more than 50% in the early 1990s to about 29% in 2010. Various social indicators also improved, such as the expectation of life at birth, which increased to 66 years in 2011; in other words,10 years longer than that estimated in 1980.

More rapid economic growth, however, is needed to accelerate poverty reduction. More than half a billion people in South and South-West Asia are trapped in extreme poverty. They represent nearly 40% of the world's poor, up from 27% two decades ago. Nearly one fifth of the people in the subregion are undernourished, the world's second highest proportion after sub-Saharan Africa. In Afghanistan, Bangladesh, Bhutan and Pakistan, at least 85% of the total population of these countries do not receive any form of social protection. Income inequality also widened in large countries in the subregion, such as Bangladesh, India and Sri Lanka.

Three interconnected macroeconomic imbalances and issues have hindered faster economic growth in the subregion. First, fiscal deficits are large in most economies owing to both low revenue and high spending (see figure 2.13). The tax base is narrow due to the sizeable agricultural and informal sectors in countries of the subregion, while tax evasion is pervasive. Public spending on infrastructure projects is constrained by high spending to maintain internal security and repay outstanding debts.

Figure 2.13. Distribution of selected macroeconomic indicators in South and South-West Asia, 2005-2014 average



Sources: ESCAP, based on national sources and CEIC Data. Available from www.ceicdata.com.

Note: The chart displays the distribution of three macroeconomic variables among 10 South and South-West Asian economies. Each dot represents an economy. The macroeconomic variables are the average values for the period 2005-2014.

To finance the shortfalls, most Governments of countries in the subregion rely on domestic bank credit and monetization, which tend to crowd out private investment and add inflationary pressure. Recently, such economies as Bangladesh, Pakistan and Sri Lanka have resorted to issuing sovereign bonds in international markets as a debt-financing option. In the short term, this may help to release more funds to the business sector, but countries' vulnerability to exchange rate risk and a sudden shift in global sentiments has also increased.

Second, current account deficits are also sizeable. The reliance on imported food and energy, limited production and export capacity and a generally underdeveloped tourism sector are the key underlying factors. Overseas workers' remittance incomes, mainly from the Middle East, have buoyed foreign exchange receipts in such countries as Bangladesh and Nepal, but this also highlights the lack of decent job opportunities in the subregion. Large current account deficits are a reflection of wide saving-investment gaps in several economies, a situation which is partly underpinned by public dissaving.

The third macroeconomic issue in the subregion is high inflation. During the period 2000-2014, the average annual inflation rate stood at 10.8%, which was higher than that in all other subregions in Asia and the Pacific. In view of the dominance of traditional agriculture, crop yields rely heavily on weather conditions, which led to high and volatile food prices. Inadequate investment to boost agricultural productivity and reduce post-harvest food waste and lack of market competition in general also contributed to high prices. Persistently high inflation also keeps inflation expectations at high levels, a situation which produces an economy-wide impact. For example, gold imports surged in India as a hedge against inflation, but this action widened current account deficits, weakened macroeconomic fundamentals and increased the risk of a sharp reversal of capital flows.

In addition to macroeconomic imbalances, economic growth in the subregion has been severely constrained by infrastructure bottlenecks, particularly electricity shortages. At least half of rural residents in Afghanistan, Bangladesh and Bhutan still lack access to electricity. In November 2014, Bangladesh faced the worst nationwide power outage since 2007. A nationwide blackout also took place in Pakistan in January 2015, where the outages in rural areas were as long as 20 hours per day. This is a significant deterioration from the situation in the early 2000s when power supply still exceeded demand (World Bank, 2014). In India, although the nationwide peak-time power shortage is projected to be moderate in 2014/15, it could exceed 20% in some regions of the country (India, Central Electricity Generating Authority, 2014).

Such severe power shortages have caused significant damage among the subregional economies. In Pakistan, the official estimate in 2012 put the economic cost of the power crisis at about 2% of GDP per year. According to the World Bank enterprise surveys, a large proportion of surveyed firms in Bangladesh, India and Pakistan cited electricity shortage as the most burdensome business obstacle. They estimated that sales values would have been more than 10% higher without those outages. A wide disparity in access to electricity also hampers inclusive development in the subregion.

Addressing macroeconomic imbalances and issues together with power shortages would help South and South-West Asia in realizing the subregion's growth potential. The size of the subregion's market is huge. Its population increased steadily from about one fifth of the total global population in the 1950s to about a quarter in 2014; the population of the subregion is projected to trend upward slightly over the next two decades. A so-called demographic dividend is also expected as the larger number of young people in the population increase the size of the working-age population and lower the age-dependency ratio. The share of the working-age population (persons aged 25-64 years old) is projected to rise from 47% in 2015 to 53% in 2035, compared with close to 50% in both years as the global average. Moreover, abundant labour in the agricultural sector and a low female labour-force participation rate mean that more workers are and will remain available for higher value-added manufacturing activity. The role of merchandise exports and intraregional trade in supporting economic growth could also be increased markedly.

Thus, acceleration of domestic structural reforms is needed to reverse recent subpar economic performance. Part of the slowdown is expected, given that growth in developed economies has trended downward since the global financial crisis began in 2008. For example, the potential growth of India is expected to decrease from about 8% annually before the global financial turmoil to 6-7% in the years that followed (Anand and others, 2014). This highlights the urgent need to push forward wise policy reforms.

4.2. Recent performance, outlook and main challenges

Economic growth in the subregion increased slightly to 5.5% in 2014 from 5.1% in 2013 (see figure 2.14), but remained considerably below its pre-crisis pace during the period 2002-2007. The uptick was led mainly by stronger performance in India, which accounts for slightly more than half the output in the subregion. Growth also strengthened in Bhutan, Nepal, Pakistan and Sri Lanka, while the Islamic Republic of Iran resumed economic expansion after two years of contraction. Growth in Bangladesh and Maldives was stable at high levels.

The near-term outlook is optimistic, with a projected growth rate of 5.9% in 2015 and 6.1% in 2016. Despite more rapid economic growth, inflation is generally expected to trend downward as growth still remains below the potential level along with lower international oil prices (see figure 2.15). In some economies where inflation could speed up, such as Bhutan, expected changes in tax and subsidy policies are the key underlying factors.

The impact of external developments on South and South-West Asia is quite varied. Lower global oil prices would benefit this net oil-importing subregion. The key exception is the Islamic Republic of Iran, although its oil export outlook is complicated by uncertainty over sanctions. On exports, the weak recovery in the European Union would particularly harm the shipment of goods in Bangladesh and Turkey and tourism receipts in Maldives, while a stronger recovery in the United States would benefit shipments in countries such as Sri Lanka. Finally, revived economic activity in India would support growth in countries with close economic ties, such as Bhutan and Nepal. However, as the subregion is still largely disconnected in terms of trade, the positive spillovers from India would be limited.

Afghanistan

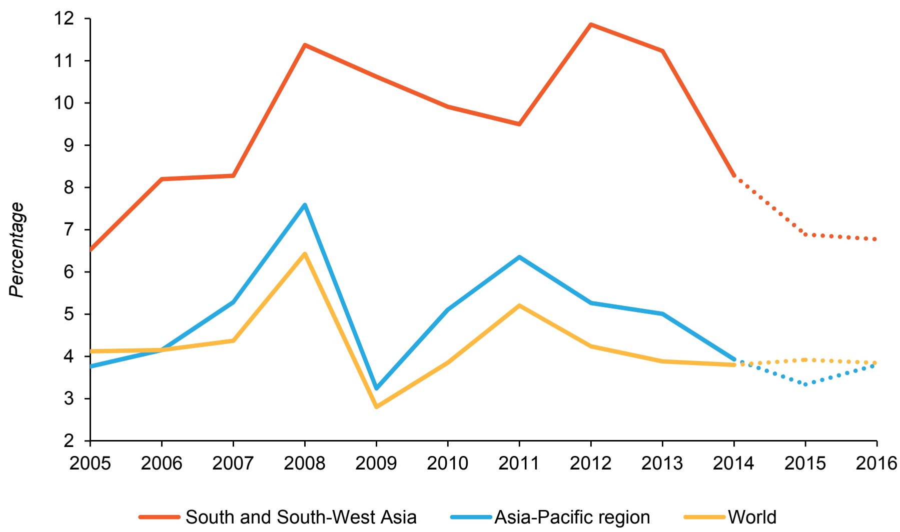
Output growth in 2014 dipped to a decade-low rate of 3.2%. Uncertainty over political transition and dismal security conditions weakened consumer sentiments. Subdued consumption along with a poor investment climate resulted in sluggish private investment and a downward trend in FDI. Similarly, government revenue was lower than expected in the light of slow economic growth and weak tax compliance. This deepened the country's reliance

Figure 2.14. Real GDP growth in South and South-West Asia, Asia-Pacific region and the world, 2005-2016

Sources: See figure 2.3.

Note: The estimates and forecasts for countries relate to fiscal years defined as follows: 2014 refers to fiscal year spanning 1 April 2014 to 31 March 2015 in India; 21 March 2014 to 20 March 2015 in Afghanistan and the Islamic Republic of Iran; 1 July 2013 to 30 June 2014 in Bangladesh, Bhutan and Pakistan; and 16 July 2013 to 15 July 2014 in Nepal. Estimates and forecasts are as of 31 March 2015.

Figure 2.15. Inflation in South and South-West Asia, Asia-Pacific region and the world, 2005-2016



Sources: ESCAP, based on national sources and CEIC Data. Available from www.ceicdata.com.

Note: See note for figure 2.14.

on external grants, which account for up to 70% of government revenue. Meanwhile, the support from monetary policy is limited due to an underdeveloped financial system, for example domestic credit to the private sector was only about 4% of GDP in 2012.

Economic growth is projected to improve in the coming few years, with growth at 4.5% in 2015 and 5% in 2016. The near-term outlook is supported by revived consumer spending amid lower inflation and easing political uncertainty. On the downside, the partial withdrawal of international forces at the end of 2014 could result in smaller donor funds and potentially more social unrest. According to the agreement signed in September 2014, more than 10,000 foreign troops will remain in Afghanistan for at least another decade to train local forces.

Weak government revenue collection, poor business environment, limited production capacity and widespread corruption are some of Afghanistan's medium-term challenges. Given that the agricultural sector is the major source of income for about half the population, expanding the agricultural land base and increasing yields would help to reduce the poverty rate, which has been stagnant at about 35% of the total population. Available data also suggest that inequality has increased between 2008 and 2012, due to volatile agricultural output in view of the dominance of rain-fed farming and the high population dependency ratio. Given the country's young population and rapid expansion of the labour force, job creation would be key to maintain medium-term growth.

Bhutan

Economic growth in 2014 increased to 6% from a low base of 4.2% in 2013. Domestic demand benefited from $72 million in off-budget fiscal stimulus and strong inbound tourism. The lifting of restrictions on housing and vehicle loans, which were introduced in early 2012 in response to rapid credit growth that led to Indian rupee shortages, also contributed to faster output growth. In contrast, hydropower generation that accounts for up to a third of GDP was below the target due to a lower volume of rainfall. Inflation remained high at 8.3% in 2014, partly due to an increase in electricity tariff of between 15% and 30% in July.

Growth in 2015 is set to strengthen further to 6.8%. Four hydropower projects are under construction, while a major hydropower project is expected to start operation in 2015. Domestic demand would be propelled by higher public sector wages and eased restrictions on imports and construction loans. Growing tourism and the disbursement of funds from India to support Bhutan's development projects would also contribute. Unlike most other economies in the subregion, inflation could escalate in 2015 owing to a pay hike for civil servants, the introduction of a 5% green tax on fuel, higher tax on imported vehicles and a scheduled increase in the electricity tariff in mid-year. Counteracting these factors would be lower inflation in India, which accounts for close to 90% of Bhutan's total imports.

The medium-term outlook for the hydropower sector is positive but macroeconomic imbalances would remain high. Hydropower export revenue is set to rise in the coming years with significant untapped potential.[10] Spillovers from hydropower projects, such as construction jobs and retail trade, have contributed to poverty reduction and overall economic growth that appears to be inclusive. Despite this, the current account deficits will likely remain large amid large imports of construction materials. The shortfall has pushed up external debt to 106.3% of GDP in mid-2014 from about 80% of GDP in 2011. Fiscal revenue also relies on foreign aid, mainly from India, which finances about a third of total spending.

Bangladesh

Growth performance was stable in 2014 at 6.1%. Except for 2009 when growth moderated to 5.7%, strong manufacturing and trade activities have helped the economy to grow by at least 6% per year since 2004. The garment sector accounts for about half the country's foreign exchange earnings and directly employs about 4 million workers. In response to the collapse of a large-scale garment factory in April 2013, the Government set up a high-level committee to work on improving working conditions. The accident led to the withdrawal of some export privileges, which appeared to have held back garment exports in mid-2014 given its lagged impact. Meanwhile, workers' remittances picked up in late 2014, in line with a higher number of overseas workers, after the contraction in 2013 that was driven by tighter migration regulations in the Middle East.

The prospects are positive, with growth being projected at 6.3-6.5% over 2015/16. Private consumption should benefit from steady growth in farm incomes and workers' remittances. Lower inflation, which is forecast to decrease to 6.5% in2015 relative to the average of 8.6% in the preceding three years, should also buoy household spending. Fixed investment is likely to rise on schemes to improve safety and the conditions of workers. The Government cancelled tax duties on construction materials and safety equipment to support such investment. Meanwhile, sluggish economic activity in key export markets, such as the European Union, will hold back shipments. This could dampen the prospects for inclusive growth since most garment workers are low-skilled female workers.

The medium-term growth outlook is optimistic, supported by a demographic dividend and the availability of low-wage workers. Rapid economic growth is conditional on greater efforts to enhance government revenue collection, boost infrastructure investment and reduce red tape. Translating growth into poverty reduction is critical, as the poverty rate remained high at 31.5% in 2010.

India

Output growth edged up to 7.4% in 2014, from 6.9% a year earlier. Macroeconomic stability has also improved in recent quarters. For instance, restrictions on gold imports that had been in place since August 2013 were lifted in November 2014, pointing to stronger external account positions. Similarly, inflation has reached a multi-year low, while manufacturing activity has revived, albeit unevenly. Despite the recent rebound, growth has been subpar since 2011.The slowdown coincided with a notable deceleration in investment growth, constrained by economic policy uncertainty, weak market confidence and high real interest rates (Anand and Tulin, 2014).

Growth is forecast to accelerate to 8.1% in 2015 and 8.2% in 2016, benefiting from the acceleration of infrastructure projects, strong consumer spending due to lower inflation and monetary easing and gradual improvements in market sentiments. Investment should also rebound, although unevenly given the still low capacity-utilization rate at about 70%. The current account balance would benefit from lower oil prices. Volatile capital flows that may follow monetary policy normalization in the United States remain the downside risk.

The decline in inflation benefits from lower global energy prices, but structural factors that keep food prices high remain. These include post-harvest food waste that is up to 40%, lack of market competition, higher agricultural input prices and wages and an increase in minimum support prices. More than half of India's farming is rain-fed, so food prices are subject to weather conditions.

Structural reforms are gaining momentum since the new administration took office in May 2014. These include opening up of 120 million new bank accounts to promote access to finance and easing FDI restrictions in such sectors as defence equipment, railways and construction. The "Make in India" initiative was launched in September 2014 to promote India as a global manufacturing hub. The success of this scheme would require broad-based policy actions in enhancing human capital, access to inputs and finance, and better connectivity. In this regard, the Government introduced online services for environmental and forest-related clearances and launched an online system to replace cumbersome labour-related forms.

One of the key remaining challenges is to address labour market rigidities[11] and generate enough jobs for 8 million new job-market entrants per year. According to the 2013 economic census, annual job growth was 4.3% on average during the period 2005-2013, up from 2.5% in the 2005 census. However, as half of India's workers still work in agriculture, the country needs to raise its productivity by engaging more in higher value-added production. This would help the country to realize its potential for growth, which is supported by a high savings rate and emerging middle-class population, and further cut poverty, which remained high at 22% of the total population in 2012.

Islamic Republic of Iran

Economic growth resumed in 2014 after two years of contraction. However, the rebound at 1.9% is modest compared with the cumulative decline of 7.5% over 2012/13. The Interim Nuclear Agreement and Talks on a Comprehensive Accord that was agreed in January 2014 led to suspension of some international sanctions that had depressed oil exports and financial transactions since 2012. Oil exports recovered moderately in 2014, driven partly by a surge in condensate exports, which were not affected by the sanctions. The interim deal also released oil revenues of $7 billion that had been frozen in foreign banks during the first 11 months of 2014.

The central bank's efforts to restrict the monetary base and create a more stable exchange rate contributed to lower inflation in 2014. The inflation rate declined to 17.2% from an average of 32.6% over 2012/13, which was driven by sharp currency depreciation and shortages of goods due to sanctions. However, subsidy cuts pushed up prices of various utility and fuel items by between approximately 20% and 72%. The Government provided cash transfers to mitigate the impact of subsidy cuts. However, as the scheme is weakly targeted, the official estimate suggests that the cost of the transfers exceeds savings from subsidy cuts.

Economic growth is expected to remain relatively low at the rates of 0.9% in 2015 and 1.3% in 2016. Lower global oil prices and subdued oil export volume would serve to dampen government revenue, so fiscal support is expected to be modest. The budget for 2015 is designed to balance the country's public finances through lower capital spending, as current spending is set to rise as the result of a public pay hike. The tax revenue-to-GDP ratio remains low at about 7%, as public finance continues to rely heavily on oil revenue. A key policy effort is to mitigate the impact of sanctions on the economy and to combat inflation.

The medium-term prospects are conditional on additional investment to translate potential in the energy sector into prosperity. The country accounts for close to 20% and 10% of the world's gas and oil reserves, respectively, but efforts to promote large-scale foreign investment projects have been hampered by the sanctions. An enabling business environment, such as a stronger financial sector and greater transparency, would address currently subdued domestic investment and downward trend in FDI.

Maldives

The economy grew at an impressive rate of 8.5% in 2014, underpinned by strong tourist arrivals. Rapid expansion in the number of visitors from China has helped offset a slowdown in arrivals from such traditional markets as Europe. The tourism sector directly accounts for about 30% of GDP and up to 75% of GDP if related sectors, such as construction, transport and communications, are included. Growth is projected to increase to 10.5% in 2015 on buoyant tourism activity.

Adequate fiscal space is needed in small, open economies such as Maldives, which are vulnerable to natural disasters and the adverse effects of climate change. Fiscal deficits amounted to nearly 5% of GDP during the period 2012-2014 despite the high revenue-to-GDP ratio of 32%. A large part of expenditure is on rising public sector wage and pension bills, subsidies on food and electricity, and transfers to State-owned enterprises. Public debt increased to 86% of GDP in 2013 from 58% in 2009, so stronger oversight of budget execution is needed. Meanwhile, weak fiscal positions have led to rapid growth of public loans, which crowded out private sector loans and exacerbated financial sector risk.

The country's medium-term development is constrained by a small, narrow economic base and scattered population that results in high fixed costs of public service provision. Human capital also appears undersized as reflected in the large number of expatriates working in the country. To address economic concentration, the Government promotes special economic zones and plans to develop new, labour-intensive sectors, such as off-port shipping services and financial services. To promote more inclusive growth, the Government plans to ensure equity of public subsidies and reduce skill mismatches among youth. Youth unemployment is high at 32%, while poverty appears to have stagnated at about 8-9% during the period 2003-2010.

Nepal

Growth reached a multi-year high rate of 5.5% in 2014, from an average of 4% in the preceding three years. Agricultural output growth accelerated due to a favourable monsoon season in 2013 and fewer interruptions in the supply of key agricultural inputs. However, the inflation rate stood at 9% in 2014, slightly above the official target of 8%. Remittance incomes, which account for about a quarter of GDP, also rose notably on the higher number of overseas workers. Together with strong farm and remittance incomes, increased tourist arrivals helped to sustain private consumption amid a rapid price rise.

Growth is expected to remain at relatively high rates of 5% in 2015 and 4.7% in 2016. Some of the key drivers are demand in India, which accounts for about 40% of Nepal's exports, and a large increase in fiscal budget as a result of underspending in recent years. FDI is also expected to rebound after a steep decline in 2014. The overall outlookshould also benefit from relatively better security conditions. Meanwhile, inflation is expected to decrease to 7.8% in 2015 from 9% in 2014 due to softer inflation in India given the pegged exchange rate and close bilateral trade between the two economies. Inflation would remain high, however, partly due to liberalization of retail petroleum prices in October 2014. To mitigate the impact of subsidy removals, the Government set up a $5 million fund that would be used to support household incomes if prices rise too sharply.

To secure the goal of becoming a middle-income country by 2022, Nepal may have to rely less on workers' remittances and focus more on strengthening domestic investment. Its poor business climate and infrastructure and energy shortages are key investment impediments. To reduce the poverty rate further, which still stood close to 25% in 2010, the Government could provide incentives for households to spend more remittance incomes on initiatives to enhance agricultural yields.[12]

Pakistan

The economy expanded by 4.1% in 2014, a slight pickup from the average growth rate of 3.7% in the preceding three years. Declining inflation, relatively better growth in private sector credit and robust workers' remittances helped propel consumer spending. More modest price pressure led to a policy rate cut in November 2014 followed by another cut in January 2015. The settlement of the Government's overdue payments to independent power producers also contributed to a more favourable macroeconomic environment, although overdue payments recently increased again. Meanwhile, market confidence in Pakistan's outlook seems to have improved. In April 2014, the country issued sovereign bonds in international markets for the first time in seven years. The oversubscription of the $2 billion in bonds was in part due to the high interest rate offered and the abundant liquidity available in international markets.

The growth outlook is forecast to be favourable at 5.1% in 2015 and 4.8% in 2016. Expected growth acceleration in 2015 would be mainly due to the expected pickup in industrial activity. The economy will still be constrained, however, by macroeconomic imbalances. In recent years, persistently high fiscal deficits, financed by borrowings from the banking system, including the central bank, have crowded out private investment and added to inflationary pressure. Similarly, supply-side constraints, such as poor domestic security conditions, unfriendly investment climate and severe power shortages, remain in place. Sustained economic growth is needed to help generate more jobs and cut poverty, which remained at 13.6% in 2011.

Nevertheless, fiscal consolidation efforts have continued. The fiscal deficit contracted to 5.5% of GDP in fiscal year 2014, mainly due to one-off non-tax revenue receipts, such as proceeds from the sale of 3G spectrum in the telecommunications sector. Similarly, selling stakes in a bank raised $387 million in June 2014. Despite some progress, a narrow tax base, widespread tax evasion and required restructuring of loss-making State-owned enterprises will continue to limit revenue collection. At the same time, improving fiscal conditions through expenditure cuts may be difficult due to the rigid structure of government spending. For example, debt servicing and military spending account for more than half of total budgeted expenditure.

Sri Lanka

Growth performance has strengthened since the civil war ended in 2009, in part due to reconstruction efforts on road networks, hospitals and schools. The economy expanded by 7.4% in 2014, up from an average of 6.8% over 2012/13. Private consumption drove the economy, supported by rapid growth in tourism and remittance receipts, the decades-low inflation rate, a rebound in agricultural output after a drought in late 2013 and monetary easing. Goods exports also advanced well.

Growth is expected to remain at the high rates of 7.5% in 2015 and 7.6% in 2016 on continued strength in private consumption. Investment will be supported by ongoing reconstruction and a planned increase in infrastructure spending. Exports should benefit from an economic recovery in the United States, which remains Sri Lanka's largest export market. State-led development will continue in the light of the planned increase in public sector salaries and State pensions. Meanwhile, output growth in recent years appeared to stay above the estimated potential growth rate of 6.7%. The inflationary impact of excess demand conditions should be monitored closely (Ding and others, 2014).

The strong economic growth record, rising agricultural prices and higher labour productivity translated into a lower poverty rate of 7% in 2012, down from 23% a decade earlier. Overall income inequality indicators have also improved. Despite the impressive growth record, macroeconomic fundamentals are rather weak with large twin deficits. The current account deficit, which stood at close to 5% of GDP per year during the period 2010-2014, reflects the high investment rate of about 30% of GDP and the low domestic saving rate. A greater role for the private sector, including FDI, in the economy is needed in order to raise exports and productivity. On the fiscal side, the deficit amounted to about 6% of GDP per year during the period 2010-2014, largely underpinned by a declining share of revenue in GDP. A significant portion of the fiscal shortfall is financed through foreign funds. As a result, Sri Lanka's external debt-to-GDP ratio is higher than that of most other economies in the subregion. This will make the country more vulnerable to rising global interest rates in coming years.

Turkey

Economic growth declined to 2.9% in 2014 from 4.2% in 2013. Growth in recent years has trended downward from an average of 6.7% in the pre-crisis years from 2002 to 2007. Sharp interest rate rises and measures to control consumer loan growth introduced in January 2014, which were aimed at stopping capital flight and reducing the current account deficit, held back consumer spending. Private consumption was also weighed down by a double-digit non-agricultural unemployment rate. Fixed investment contracted due to weak demand, much higher borrowing costs and a relatively low manufacturing capacity utilization rate. A poor harvest contributed to higher inflation of 8.9% in 2014, which was above the medium-term target of 5%.

Growth is projected to rise to 3.3% in 2015 and 3.7% in 2016. Consumer spending should rebound modestly on stronger sentiments and lower inflation. The weak currency would support exports, although orders from Europe, which is Turkey's main export market, are expected to remain subdued. Improved exports, lower global oil prices and still sluggish import demand would help reduce the current account deficit. A key downside risk is likely volatility in capital flows relating to a possible interest rate increase in the United States. In view of the low domestic saving rate, Turkey has relied on foreign funds to finance its economy, thus being sensitive to sharp changes in global risk appetite. In order to manage currency volatility, the central bank recently expanded its foreign-exchange sales, reduced the interest rates on foreign currencies and raised foreign-exchange reserve requirements.

Part of the reform agenda is focused on creating more jobs. With half the population younger than 30 years of age, pressure on job creation would be high in coming years. The youth unemployment rate is currently close to 20%. Adoption of a new employment strategy to make the labour market more flexible is important.

4.3. Selected medium-term policy challenges

As highlighted in previous sections, power shortages are a serious issue in South and South-West Asia, as they have a critical impact on social and economic development. Governments of countries in the subregion are thus trying to address this energy crisis. In Pakistan, the construction of a coal-fired power plant began recently, while new power plants are being commissioned and State enterprises in the energy sector are under privatization plans. Similarly, privatization deals in Turkey's energy sector are moving forward. In Bangladesh, the Government approved a plan to build a $4.6 billion power plant, and in late 2014 it announced that it would issue sovereign international bonds worth $2 billion in 2015 to finance infrastructure projects. In India, coal mines were auctioned to private firms in late 2014. Coal shortages have limited the operation of power stations to only 75% of their capacity. Meanwhile, Nepal is encouraging more bank lending to the hydropower sector, which is considered as one of the country's strategic sectors. At the eighteenth summit of the South Asian Association for Regional Cooperation, which was held in Kathmandu in November 2014, agreement was reached that promotes the expansion of transmission networks and guarantees non-discriminatory access to electricity within the subregion.

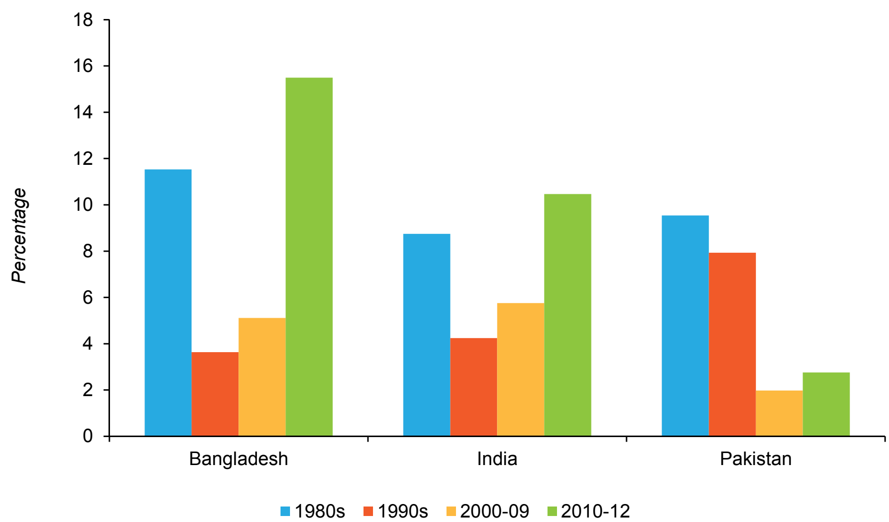
The question remains whether these policy actions are sufficient to help countries in the subregion meet their goals. For example, Bangladesh plans to achieve universal access to electricity by 2021, from about 60% currently. The root causes of energy shortages in South and South-West Asia lie beyond energy sector policies, so addressing the outages also requires a broad-based policy effort.

Persistent electricity shortages are due to a number of factors. First, the underpricing of electricity tariffs and input prices, such as gas and coal, discourages further production and the entrance of new market players. Past efforts to raise prices often faced strong social and political opposition.[13] Second, the limited electricity-generation capacity is aggravated by high rates of transmission and distribution losses, which are due largely to ageing infrastructure, theft and the inability to collect power bills. The losses are estimated at up to 30-40% of total electricity production in Afghanistan and Nepal and close to 20% in India and Pakistan, relative to only 7% in OECD member countries, according to IEA data. Third, weak corporate governance of State enterprises in the energy sector results in inefficiencies and a large subsidy burden. For example, in Pakistan, power distribution companies are unable to collect a large portion of their bills, thus constraining the financial liquidity of power-generation companies and energy suppliers, and causing circular debt in the energy sector.

Addressing the energy crisis requires broad-based policy action. More investment is needed to boost power-generation capacity. For example, figure 2.16 shows that growth in installed capacity in Pakistan has moderated in recent years compared to the rates in the 1980s and 1990s. It is estimated that economies in the subregion would need to spend between 2.2% and 2.9% of GDP per year over a decade to close gaps in the power sector (Andrés, Biller and Dappe, 2014a). To boost more investment in the power sector, Governments need to expand the fiscal space and consider more financing through private-public partnerships.

In this vein, countries in the subregion have introduced various measures to enhance the fiscal space. On the revenue side, Afghanistan, Bangladesh and Maldives adopted more computerized data management systems to improve tax collection efficiency. Various tax rate hikes have recently been implemented or are being planned, such as the tourism goods and services tax in Maldives, the corporate income tax rate for small and medium-sized enterprises in Sri Lanka and the service taxes in Pakistan. Pakistan is also considering withdrawal of tax exemptions for some industries. Similarly, new taxes have recently been introduced or are being planned, such as the telecommunications tax in Maldives, wealth taxes in Bangladesh and a nationwide goods and services tax in India. Finally, there are plans to develop the mining sector in Afghanistan

Figure 2.16. Annual growth of electricity installed capacity in selected South and South-West Asian economies, 1980-2012



Sources: ESCAP, based on data from the Unites States Energy Information Administration.

and to tackle tax evasion in Sri Lanka in order to boost tax revenues. On the expenditure side, India deregulated domestic diesel prices and raised excise duties on fuel items, while Turkey increased prices for household electricity and gas in order to reduce the subsidy burden.

Despite some progress, the fiscal space remains generally limited, which points to the need for an appropriate framework for public-private partnerships. Such a framework includes, for example, setting up institutional frameworks to support project identification, preparation, implementation and monitoring; creating a risk-sharing mechanism that ensures fiscal sustainability; and harmonizing relevant regulations to reduce investment uncertainty. In this regard, the Government of Turkey announced in late 2014 programmes to encourage firms to participate in more public tenders. Bangladesh also set up a committee chaired by the Prime Minister to speed up large-scale investment projects. An enabling public-private partnership framework is expected to boost private investment in public infrastructure projects, which so far has been small. Investment in infrastructure with private participation stood at about $7.2 billion per year during the period 2000-2011, compared with $8.3 billion and $15.8 billion in East Asia and the Pacific and Latin America and the Caribbean, respectively.

On corporate governance, State enterprises should be commercially oriented, with cost effectiveness and operational efficiency being made part of the performance indicators. The Government should ensure open, competitive selection of board members, managerial autonomy and transparent business operations that are subject to review by an independent regulatory body. Recent assessments of State enterprises in the energy sector in Bangladesh, India and Pakistan suggest that State interference is high, a situation that weakens incentives for corporatization.[15] Separation of the Government's role as an owner and regulator is not always clear. As a result, board members are often politically appointed, lack decision-making authority and are not properly evaluated on their performance. Accountability to investors and the public in general is low. Thus, the South and South-West Asian subregion seems to lag behind in this area, and concerted efforts are required to address these concerns.

5. SOUTH-EAST ASIA

5.1. Key economic and social themes

Highly open to international trade, the South-East Asian subregion is well known for its extensive production networks of electronic and automotive parts. However, exports have contributed less to economic growth in recent years as weak global demand was offset by strong domestic demand, particularly private consumption. This trend reflects South-East Asia's place in the world today as both a production base and a growing market of 620 million people; it is also playing a role in the broader rebalancing of the global economy. However, there are concerns that the recent strong expansion of domestic demand was too credit-driven, while weak export performance partly reflects supply-side weaknesses in physical and human capital. For instance, household debt and real estate prices have risen rapidly in some countries, even though long-term investment in infrastructure remains low and the shortage of skilled labour is cited as a major constraint by employers. At the same time, public spending on social protection remains low, making families living just above the poverty line vulnerable to even small shocks. These challenges are discussed below; policy options for addressing them are discussed in the final section.

On aggregate, South-East Asia continues to perform well in terms of exports and FDI inflows, but performance varies widely; the composition of exports raises concern in some countries. South-East Asia's share of global exports rose back to about 7% in 2013, similar to the level in 2000, after falling in the years in between amid China's rapid expansion. FDI inflows rose to a record $125 billion, or 9% of global FDI inflows, in the same year.

However, performance varied widely. Thailand's export growth was flat in 2013 and 2014, in contrast with the strong performance of Malaysia and Viet Nam and with its annual average growth of 13% in the preceding decade. Some argue that Thailand's electrical and electronics sector, which relies heavily on manufacturing hard disk drives, failed to adjust to modern technologies and trends.

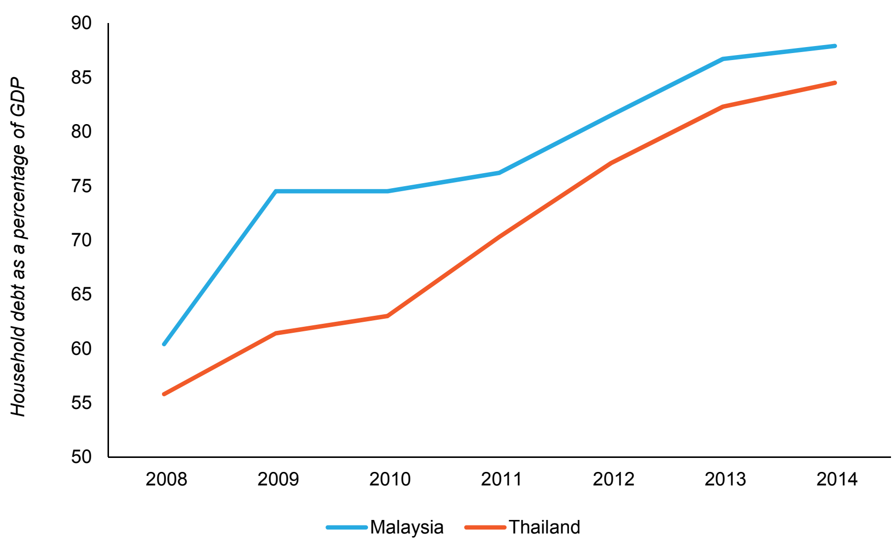
The Philippines has long received far less foreign investment than the size of its economy or labour force would suggest; even with recent improvements, FDI inflows stood at only $3.9 billion in 2013. Restrictions on foreign ownership and otherregulatory barriers are often cited as reasons for this situation. At the same time, the share of high-skill and technology-intensive manufacturing remains relatively low, at about 20% in Indonesia and the Philippines, 10% in Viet Nam and 1% in Cambodia, compared with Singapore's 50%. Cambodia has been unable to diversify beyond the manufacture of garments, while Brunei Darussalam, Myanmar and Timor-Leste rely heavily on the production of oil and gas. Similarly, a number of countries are not well integrated into regional value chains, limiting their ability to diversify their economic structure.

A prolonged period of low interest rates and massive liquidity has resulted in some side effects, including rising household debt and increased exposure of banks to the real estate sector. The consequent increase in domestic private consumption has contributed to strong growth in recent years, supported by stable prices and favourable credit conditions. In Thailand, tax exemptions on first car purchases and farm subsidies also temporarily boosted spending. While much of this has been a positive story of the rising middle class, the period also witnessed increased household leverage and real estate speculation. Between 2008 and 2013, household debt as a percentage of GDP rose from about 60% to 87% in Malaysia and from 55% to 82% in Thailand (see figure 2.17), so that loan repayment as a share of household income rose to 44% and 34% respectively. While largely manageable so far and unlikely to trigger instability, high debt can act as a drag on growth by constraining consumption in the years ahead and limiting the policy space with regard to interest rates.

At the same time, the real estate sector has been booming in some countries and banks' exposure to the sector has increased not only through loans but also through debt and equity securities that finance real estate activities. For instance, in the Philippines, the price of land in the financial district of Makati surged by 28% from 2010 to 2013 to the highest level since 1997, while banks' exposure to the real estate rose to 22%; although lower compared with the level in Singapore or Malaysia, the backdrop of the recent increase raises concerns. Again, there is no immediate risk, as South-East Asia's banks are well capitalized and subject to a number of macroprudential measures. However, it is always better to be cautious against signs of asset bubbles. Another lesson is the need to look at the composition of domestic demand more carefully.

Long-term investment in infrastructure should figure more prominently in domestic demand; this is also vital for South-East Asia's export competitiveness. Since the Asian financial crisis

Figure 2.17. Household debt levels in Malaysia and Thailand, 2008-2014



Sources: ESCAP, based on CEIC Data and national central banks.

of 1997, South-East Asia has largely been a net capital exporter, as reflected in large capital account surpluses. However, as countries built up foreign currency reserves for self-insurance, South-East Asia's surplus savings were invested largely in United States Treasury bills rather than in its own infrastructure development and other needs; central banks in South-East Asia hold reserves worth more than $700 billion.

At the same time, government spending on infrastructure has been chronically low in Indonesia and the Philippines and recently missing in Thailand. On average, public infrastructure outlays dropped from 6% of GDP in the period 1980-2009 to about 4% today, while private participation in infrastructure fell from $38 billion in 1997 to $25 billion in 2010 (Groff, 2014). The consequence is that South-East Asia has barely 10 km of roads and 0.5 km of rail per 1,000 people, compared with the OECD average of 200 km and 5 km respectively; the electrification rate is 72% and only 86% have access to clean water. At the same time, the demand for roads, railways, ports and airports is rising rapidly. Air travel is growing swiftly, with low-cost budget carriers placing huge orders for new aircraft. Urbanization too is progressing rapidly; across South-East Asia, more than 90 million people are expected to move to cities in the next 15 years, putting a strain on transit systems, housing, power and water supplies (Woetzel and others, 2014). Unless action is taken, infrastructure deficits will constrain productivity growth and contribute to inflationary pressures.

Improving people's skills and access to affordable health care should be a priority to address the skills shortage and build an inclusive society. South-East Asia's combined labour force is behind that of only China and India; average wages are lower than in China while manufacturing capability is stronger than in India. However, the shortage of skilled labour is widely cited as a major constraint by employers. Based on the current trend, it is estimated that more than half of all high-skill employment in Cambodia, Indonesia, the Lao People's Democratic Republic, the Philippines, Thailand and Viet Nam could be filled by workers with insufficient qualifications by 2025 (ILO and ADB, 2014). Until recently, public spending on education was less than 1% of GDP in Myanmar. The literacy rate is about 75% in Cambodia and the Lao People's Democratic Republic. Even in higher-income countries, such as Malaysia and Thailand, student performance in essential skills, such as reading, mathematics and science, are relatively weak against international comparisons (Fry, 2013).

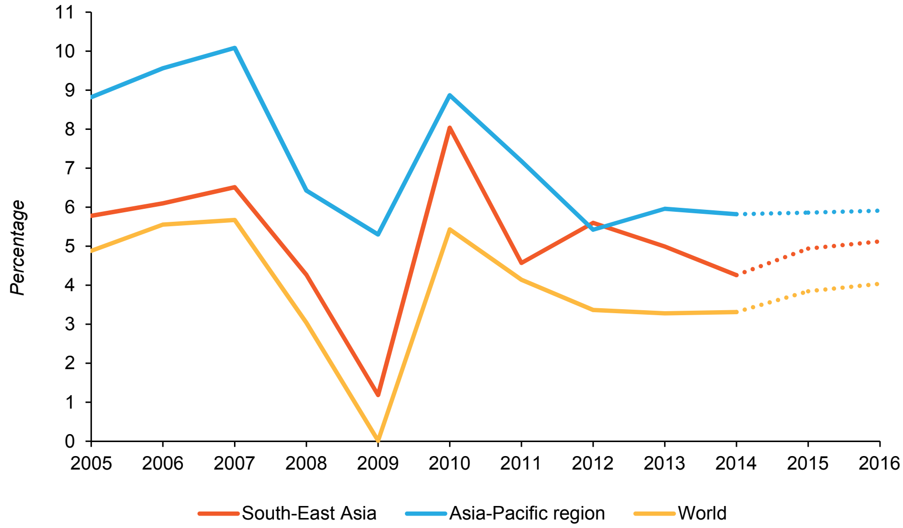
At the same time, out-of-pocket health expenditures remain too high for many families in South-East Asia, often causing them to fall back into poverty. Overall public spending on social protection was more than 3% in Malaysia, Singapore and Viet Nam but only 1% in Cambodia, Indonesia and the Lao People's Democratic Republic. The *Survey* for 2013 contained an estimate that Indonesia and the Philippines would need to increase public health spending by 8% annually in order to raise total health spending to 5% of GDP in line with WHO recommendations.

5.2. Recent performance, outlook and main challenges

Economic growth in South-East Asia as a whole moderated to 4.3% in 2014 from 5% in 2013 (see figure 2.18). Thailand was the clear underperformer owing to political unrest, but growth also slowed in Indonesia to the weakest level in five years as a result of monetary tightening and weak commodity exports. Malaysia, the Philippines and Viet Nam posted robust growth rates of 6% or more on the back of strong investment and export performance. Growth eased, albeit from a high base, in Cambodia, the Lao People's Democratic Republic and Myanmar, slowing the pace of their income convergence with the more developed economies in the subregion. In Timor-Leste, the development of the non-oil economy is urgent as oil production is expected to end within a decade. Brunei Darussalam experienced a mild rebound as oil production picked up, but diversification is a medium-term priority. Growth in Singapore moderated owing to cyclical factors and the cooling of the real estate sector.

In line with slower economic growth, inflation in South-East Asia as a whole decelerated from 4% in 2013 to 3.8% in 2014 (see figure 2.19). However, inflation remained relatively high at 6.4% in Indonesia, at the same rate as the year previously, while edging up in Malaysia and the Philippines by about a percentage point to 3.1% and 4.1% respectively. Current account surpluses have narrowed slightly compared with the levels prior to the global financial crisis. In 2014, Malaysia, the Philippines, Thailand and Viet Nam recorded

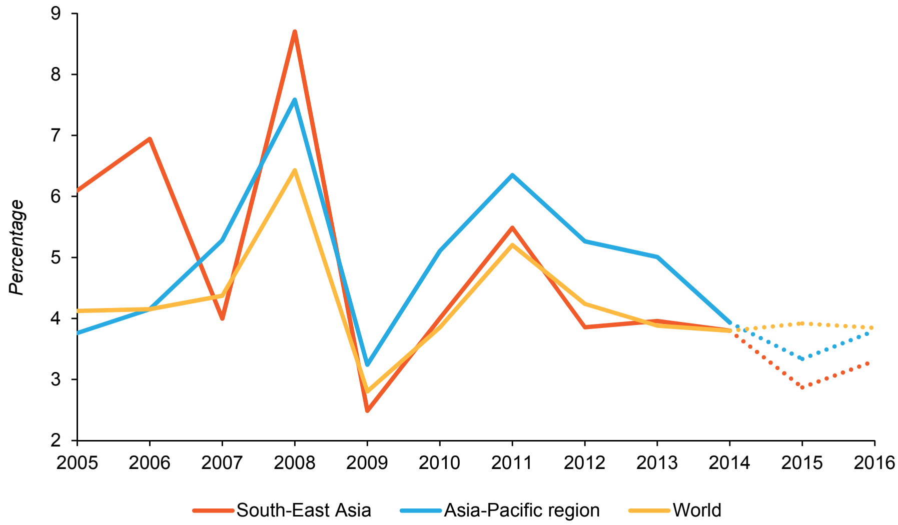
Figure 2.18. Real GDP growth in South-East Asia, Asia-Pacific region and the world, 2005-2016



Sources: See figure 2.3.

Note: Estimates and forecasts are as of 31 March 2015.

Figure 2.19. Inflation in South-East Asia, Asia-Pacific region and the world, 2005-2016



Source: ESCAP, based on national sources and CEIC Data. Available from www.ceicdata.com.

Note: Data reflect the changes in the consumer price index. Estimates and forecasts are as of 31 March 2015.

surpluses in the range of 3% to 4.5% of GDP. Current account deficits were recorded in Indonesia (3%), Myanmar (5.3%), Cambodia (8.7%) and the Lao People's Democratic Republic (25.4%). The fiscal deficit and public debt as a share of GDP remained generally low, but in countries where this was not the case, corrective measures are being taken; Malaysia is introducing a new goods and services tax in 2015 while some fiscal consolidation is taking place in the Lao People's Democratic Republic.

In 2015, growth in the South-East Asian subregion is expected to rise to 4.9%, led by a recovery in Thailand and faster growth in Indonesia and the Philippines. Growth is set to edge up further to 5.1% in 2016. Infrastructure investment will play a critical role in the growth outlook of these economies. While the recent drop in global oil prices should boost consumer spending and investment, oil-dependent Brunei Darussalam and Timor-Leste will experience revenue shortfalls. Malaysia will also be affected, but to a much lesser extent with its diversified export and production base. Inflation is likely to remain low. The medium-term outlook for all countries critically depends on structural reforms. For instance, regulatory reforms could help increase foreign investment in the Philippines while reform of State-owned enterprises and the banking sector could pave the way for a more vibrant domestic private sector in Viet Nam.

Brunei Darussalam

After contracting in 2013, the economy saw a mild rebound of 1.1% in 2014 as oil production picked up. The drop in global oil prices, however, had an offsetting effect; the total value of exports dropped by 15.5% in December 2014 compared with that of a year previously. Flat vehicle sales growth in 2014 indicated relatively subdued domestic demand. In March 2014 the Government released a strategy to raise oil and gas production over the next 20 years by using modern oil-recovery techniques and foreign investment. The non-energy sector continues to be dominated by government consumption and related construction activities, although the private sector's contribution has risen to about 20% in recent years.

Economic growth is expected to edge up in 2015 and 2016 to 1.5-2% in line with the continued recovery in oil and gas production, although lower global oil prices are expected to offset some of this gain. Higher inflation of 0.2% in 2015, from −0.8% in 2014, is expected in line with the weaker currency, which is linked one for one with the Singapore dollar. However, the large reserve assets of Brunei Darussalam, estimated at about $40 billion in 2011, and generous subsidies on food, fuel and housing imply that any adverse impact on output and inflation would be mitigated.

To diversify the economy, the Government has been promoting investment in non-energy sectors, such as agro-processing, aviation, banking, telecommunications and tourism, as well as in downstream petrochemical sectors. Successful cases in recent years include the setting up of a methanol facility, an oil refinery and an agricultural industrial park. An aviation training centre also opened in 2014.

Cambodia

The economy expanded by 7.2% in 2014, slightly lower than the rate of 7.4% in 2013. The garments sector continued to account for a significant share of total output and manufacturing sector employment, but it grew at a slower pace amid strikes initiated by labour demanding higher minimum wages. A recovery in construction activities was financed largely by foreign investment. Growth in tourist arrivals slowed due to political unrest in neighbouring Thailand and tensions between China and Viet Nam. Overall, the services sector continued to expand rapidly; Internet usage grew by more than 40% and the insurance sector by more than 25%. However, growth in the agricultural sector slowed. In particular, exports of milled rice were well short of the government target due to a lack of milling capacity and funding. Inflation edged up from 3% in 2013 to 3.9% in 2014, driven mainly by the price of meat, fruit and non-food items, such as utilities.

Faster economic growth of 7.3-7.4% in 2015 and 2016 is expected, driven by the construction and tourism sectors. The increase in monthly minimum wages to $128 at the end of 2014 has left Cambodia's garment sector less competitive than its rivals, such as Bangladesh. It is time, therefore, to move up the manufacturing value chain. While more than 3 million tons of paddy rice is available for export, the goal of exporting 1 million tons of milled rice in 2015 is unlikely to be achieved. Greater investment in milling capacity as well as in irrigation and extension is needed. Lower inflation of 2% is expected, thanks to lower imported inflation from petroleum products.

The central bank tried to control the speed of credit growth by expanding the base of reserverequirements, so that it slowed from more than 30% in 2013 to about 25% in 2014. Still, the stock of credit remains manageable at about 40% of GDP. With robust imports of construction materials and consumer durables, such as vehicles, the current account deficit widened to an estimated 8.7% of GDP in 2014 from 8.5% in 2013. However, it is expected to narrow in 2015 due to the steep fall in global oil prices. Tax revenues increased by 27% in 2014, thanks to buoyant domestic demand and stronger collection of customs and excise taxes. In January 2015, the earnings threshold for income tax exemption was raised from about $125 to $200, but the impact on government revenues will be minimal.

Indonesia

Economic growth slowed to 5% in 2014, the weakest in five years, as a number of factors weighed on investment growth, which further decelerated to 4.1% from 5.3% a year earlier. Examples of these factors include: a tight monetary policy aimed at controlling inflation and curbing the current account deficit; weak commodity prices and demand, which not only affected export revenues but also investment; and investors' wait-and-see mode in an election year. Growth was driven mainly by robust private consumption, which benefited from improvements in the labour market; employment increased by nearly 1.9 million jobs, or 1.7%, with the largest gains in construction and trade. Exports of primary commodities, such as coal and rubber, fell as growth slowed in large markets, notably China, while a mineral export ban adversely affected shipments of copper and nickel ore. Oil and gas exports also fell. Consumer price inflation rose to 8.4% in December 2014 from a year earlier as fuel subsidies were further phased out.

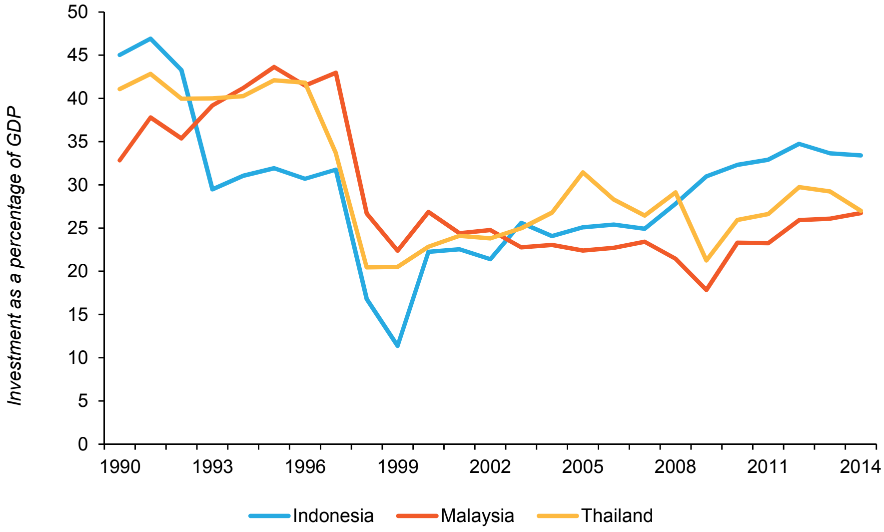
A mild rebound from higher investment and government spending is forecast, raising projected growth in 2015 and 2016 to 5.6-5.8%. Strong fourth quarter data already point in this direction. Inflation also seems to be easing rapidly; it dropped to 7% in January 2015. This may open up the opportunity to lower the interest rate, although such a decision would also depend on the current account deficit, which the central bank intends to maintain below 3% of GDP, compared with about 3% in 2014 and 3.3% in 2013. Perhaps more importantly, the strength of the rebound will depend critically on the progress in reform measures initiated by the new Joko "Jokowi" Widodo administration. The Government submitted a revised budget in January 2015, in which public works, such as roads, housing and irrigation, were more than doubled from the original allocation. If coupled with appropriate regulatory reforms, increased public investment could also help attract more private investment and keep up the strong growth momentum in fixed investment witnessed in recent years (see figure 2.20). In the medium term, this would boost Indonesia's manufacturing capacity and further reduce its reliance on primary commodities.

Macroeconomic policies in 2014 were geared towards stabilization and long-term sustainable growth, rather than boosting short-term growth. Following a series of hikes in late 2013, the central bank further raised the benchmark interest rate by 25 basis points to 7.75% in November 2014, with a view to anchor inflationary expectations amid further cuts in subsidies. Monetary policy was also influenced by the uncertain external financing environment; it was deemed undesirable that large portfolio inflows should be used to finance the current account deficit. On the fiscal side, the new administration cut fuel subsidies in November, raising petrol and diesel prices by more than 30%. Effective January 2015, petrol price subsidies were completely eliminated. This opened up some $18 billion in the budget to be reallocated to more productive areas. In announcing the most drastic subsidy reform, the Government pledged to use 60% of the savings to address the country's severe infrastructure bottlenecks. To mitigate the impact on low-income households, a number of provisions, such as social protection cards, were introduced.

Lao People's Democratic Republic

Economic growth moderated to 7.5% in 2014 from 8.5% in 2013 as mining and hydropower exports declined. The slowdown also reflected the poor performance of its major trading partner, Thailand. Growth was supported by construction in the resource sector and an increase in wood exports. Services also grew rapidly, including in wholesale and retail, transportation, storage and communications. Government consumption growth slowed considerably after having expanded rapidly in the past few years. Inflation also decelerated to 4.2% in line with stable food prices.

Figure 2.20. Investment shares in selected South-East Asian economies, 1990-2014



Source: ESCAP, based on IMF World Economic Outlook Database.

Economic growth is expected to slow further to 7.2% in 2015 and 2016 as mining and hydropower exports remain weak. The Lao People's Democratic Republic is facing increasing pressure from Cambodia and Viet Nam to delay the construction of a 260 megawatt dam on the lower Mekong River, given its potential adverse impact on fisheries and water flow. Medium-term growth will depend on the diversification of the economy. Priority areas include modernizing agricultural production, creating value-added food and agricultural products and improving management of natural resources.

The central bank allowed real appreciation of the kip against the United States dollar to control inflation. Fiscal consolidation efforts were made in 2014. For instance, salary and benefit increases for public servants were put on hold while off-budget spending was reduced, including direct lending for local infrastructure projects. Going forward, the Government needs to invest more in human capital to further diversify the economy and to take advantage of the opportunities presented by its accession to WTO in 2013 and the planned railway connecting the country to southern China.

Malaysia

Economic growth accelerated to 6% in 2014 from 4.7% a year earlier, driven by a vibrant private sector. Consumer spending grew faster, thanks to favourable labour market and credit conditions. Private investment growth too accelerated, continuing to benefit from a pipeline of infrastructure and industry projects created by the Economic Transformation Programme. However, government spending slowed in line with the goal to achieve a balanced budget by 2020 and to keep the public debt below the ceiling of 55% of GDP. Export growth was strong, particularly in the first half of the year, and was led by such manufacturing products as electronics. Still, import growth was faster and the current account surplus narrowed to about 4.6% of GDP in the fourth quarter.

Slower growth of 4.9% is forecast for 2015, before picking up to 5.2% in 2016. The expected slowdown in 2015 is due to two major factors. First, the introduction of the goods and services tax in April is likely to dampen consumer spending in ensuing months. First quarter growth may stay strong due to front-loading. High household debt burdens too will weigh on consumer spending. Second, the drop in global oil prices is likely to further spillover into gas prices in 2015. As Malaysia is a major exporter of oil and LNG, its commodity revenues will be heavily affected. Nevertheless, the overall outlook remains bright. The economy will benefit from cheaper crude oil imports. Also, non-commodity exports will benefit from improving growth prospects in the

UnitedStates and the depreciation of the ringgit. Perhaps more importantly, investment growth is expected to remain resilient as major public infrastructure projects take off.

Malaysia's central bank was the first to raise the policy interest rate in South-East Asia in 2014, by 25 basis points to 3.25% in July, but it has since kept the rate unchanged, maintaining a generally accommodative stance. The rate hike partly addressed concerns related to high household debt and the negative real interest rate as inflation accelerated. On the fiscal side, a number of changes took place. In December 2014, the Government further phased out fuel subsidies. In January 2015, it lowered its oil price assumption to $55 per barrel (from $100); given that oil-related contributions make up almost 30% of revenues, a significant revenue shortfall is forecast for 2015. Regardless, major projects, such as the planned second mass rapid transit line, the light rapid transit extension and the Kuala Lumpur-Singapore high-speed rail line, will proceed as planned. The 6% goods and services tax to be introduced in April will replace the services tax and the sales tax, which cover a narrower range of goods and services. Initially, the net fiscal impact will be almost neutral, as the goods and services tax will be offset by a lower personal income tax rate and cash transfers to low-income households. Given the lower growth outlook, tariff increases for electricity and gas were postponed to reduce the burden for businesses.

Myanmar

Economic growth is expected to ease to 7.8% in fiscal year 2014/15 (ending in March) from 8.3% in 2013/14 due to weak agricultural output. Since the initiation of reforms in 2011, the economy has been expanding at a rapid pace on the back of exports of natural gas and investments in the energy sector. New business registration grew rapidly and capital imports remained strong. This trend largely continued in 2014. With strong import growth and relatively weaker export growth, the trade deficit widened to 5.5% of GDP in December 2014. This, together with the strengthening of the United States dollar, affected the recent depreciation of the local currency. Private sector access to credit continued to grow rapidly, by well over 30%. Inflation was observed to have risen to 5.9% in fiscal year 2014/15 from 5.7% in 2013/14, as food prices increased due to strong domestic demand coupled with weak agricultural output.

Economic growth of 8.3% and 8.2% is projected for 2015/16 and 2016/17 respectively. Performance this year could hinge on important political events, including the planned constitutional referendum in May and the national elections in December. Continued momentum in economic reforms will also be important. In particular, efforts to expand the production base should be accelerated in the light of the downward volatility in global commodity prices. This includes the special economic zone being developing jointly with Thailand, the country's second largest foreign investor. In addition to low-wage manufacturing, the agricultural sector is another area with great potential. Despite a large endowment of arable land and water, the level of agricultural productivity remains one of the lowest in the region.

The central bank awarded licences to nine foreign banks in October 2014, giving them authority to operate in restricted services, such as wholesale banking. Opening of the first stock exchange is planned towards the end of 2015. The World Bank's Doing Business report suggests that enforcement of contracts remains weak. Contracts and judicial system reform will be important for the financial sector to develop. Meanwhile, government consumption has been increasing rapidly, with higher civil service salaries and transfers to local governments. The Government is targeting a budget deficit of 5% of GDP in 2015/16. Envisioned under Myanmar's Social Protection Strategic Plan, adopted in January 2015, are targeted cash transfers, school nutrition programmes, public employment and vocational education programmes, and social pensions to be gradually phased in over the next decade. The introduction of treasury security auctions in January 2015 was a step forward in establishing a non-inflationary alternative to central bank deficit financing, even though only half of the $50 million offering was sold.

Philippines

Economic growth eased to 6.1% in 2014 from 7.2% a year earlier, as government spending slowed markedly due to legislative challenges; the Supreme Court ruled that the Government's Disbursement Acceleration Program was unconstitutional. Nonetheless, growth was still robust and driven by consumer spending, which benefited from improvements in the labour market and steady overseas workers' remittances; more than 1 million jobs were created in 2014 and unemployment fell to 6%, the lowest in a decade; even youth unemployment edged down slightly to about 14%. Fixed investment in equipment continued to exhibit robust growth although construction slowed, albeit from a high base. Electronics and apparel exports posted strong growth; in services trade, the Philippines overtook India as the call centre of the world, with more than 1 million employed at call centres and in related outsourcing businesses. Inflation accelerated from strong liquidity and credit growth and from higher food, electricity and petroleum prices.

With the rebound in government spending and lower inflation, thanks to the drop in global oil prices, higher growth of 6.5% and 6.4% is projected for 2015 and 2016 respectively. Congress passed a supplementary budget in December 2014, and the Government is expected to accelerate spending ahead of the six-month moratorium on project approvals prior to the national election in May 2016. The services sector will continue to drive growth; in particular, the business process outsourcing sector is expected to generate some $25 billion in revenues by 2016, accounting for a tenth of the economy. Remittances from some 11 million overseas workers will also continue to account for a tenth of the economy. In going forward, it is important to keep expanding the traditionally weak manufacturing base through regulatory reforms as well as increased public investment.

As inflation accelerated, the central bank first raised the reserve requirement ratios, before increasing the policy interest rate by 50 basis points to 4% in September 2014. As prices began to stabilize, however, the policy rate has since been kept on hold. A number of financial stability measures were introduced as banks' exposure to the property sector grew rapidly, including the credit risk management framework, the real estate stress test and the expanded definition of real estate exposure. On the fiscal side, the Government has made significant progress in recent years in boosting tax revenues and enhancing private participation in infrastructure. It has rolled out several midsize public-private partnership projects; as of January 2015, nine such partnership contracts had been awarded, mostly to domestic firms, and nearly 50 are in the pipeline. Foreign participation may be needed in larger projects, such as construction of a planned subway and commuter railway. Reconstruction efforts in typhoon-affected areas are ongoing, and a dedicated website was launched to transparently track the progress. The Government intends to increase total infrastructure spending to 5% of GDP by 2016.

Singapore

Economic growth eased to 2.9% in 2014 from 4.4% a year previously. Services continued to drive growth, including finance and insurance, business services and wholesale and retail trade. Manufacturing growth was mainly in the biomedical and chemical clusters. Construction growth was flat owing to the cooling property market and a shortage of labour. Unemployment edged down to 1.9% in the third quarter. Capital investment in the electronics sector fell more than 50% from the year before, but this was due to cyclical factors. Mild deflation was recorded in November and December, mostly from supply-side factors, including the drop in global commodity prices, new health-care subsidies, increases in the availability of car licences, and falling rents.

Growth for 2015 is forecast at 3.1%, before increasing to 3.5% in 2016. As a net importer of oil, Singapore is expected to benefit from the fall in global oil prices. This could translate into lower electricity tariffs and fuel costs, helping businesses to lower their input costs, while boosting consumers' purchasing power. In addition, exports are expected to receive a boost from the slower appreciation of the currency, as announced by the monetary authority. The medium-term outlook is bright as the economy shifts to higher value-added activities; for instance, Singaporean electronics firms are now placing more emphasis on such activities as chip design and delivery of services-driven information technology solutions.

In January 2015, the monetary authority announced that it would maintain the modest and gradual pace at which the Singapore dollar appreciates against a basket of other currencies but reduce the slope of the band within which the trade-weighted exchange rate fluctuates. The move came in response to a sharp slowdown in inflation, which is forecast at only 0.3% in 2015. Fiscal policy is largely focused on promoting higher value-added activities and strengthening social safety nets and making health care affordable.

Thailand

Economic growth dipped to 0.7% in 2014 amid political unrest. The economy contracted in the first half of the year, as consumer sentiment and investments fell amid significant political uncertainty; another contributing factor was declining domestic demand for vehicles and parts, which resulted in a mild contraction in manufacturing. With the resumption of government functions, the economy began to recover in the second half of the year but very slowly. A stimulus package on the order of $11 billion was announced, with a focus on jobs and helping farmers, but the impact was not felt in 2014 due to delays in disbursement and implementation. Exports, which make up the equivalent of about 70% of the economy, also faltered; 2014 marked the second consecutive year of negative export growth, which contrasts with the annual average pace of growth of about 13% in the period 2002-2012. Employment growth was also negative, with notable declines in agriculture and construction.

In 2015 and 2016, a mild rebound to 3.9-4% growth is forecast. On balance, the economy should also benefit from the lower cost of production due to the drop in global oil prices, although already weak farm income might be worsened by a decline in agricultural commodity prices, such as those for rubber and sugarcane. Consumer spending may benefit from the fiscal stimulus, but will remain constrained by high household debt. A recovery in construction and in tourism will also provide a boost to the economy. Perhaps more importantly, large public infrastructure projects are expected to begin and start making progress in 2015, although more delays in disbursement and implementation are possible. Investment from Japan is expected to rise after having fallen by 37% in 2014. National elections, tentatively scheduled for early 2016, could boost confidence in the economy.

In March 2014, the central bank reduced its policy interest rate by 25 basis points to 2%, the lowest in three years, with a view to support the contracting economy. It has since kept the rate on hold. Unpaid farmers were paid after the military took over in May 2014, but the farm subsidy programme itself was discontinued. Regardless, improving agricultural productivity will be important for narrowing the wide urban-rural income gap. After a number of delays, the planned multi-year public transport investment programme is expected to take off in 2015. This could boost domestic demand while increasing the economy's long-term competitiveness. Thailand's ranking in the global competitiveness index fell from 33 in 2007 to 67 in 2014. Thailand should also take advantage of the integrating market and production base under the ASEAN Economic Community, including in the automotive sector where the country already has a huge advantage. To finance the required expenditures, a number of tax reform proposals are under review. Plans to return the VAT rate to the earlier 10% were postponed, but a 1 percentage point increase from 7% to 8% may go ahead in September 2015 if economic recovery continues. The fiscal deficit is forecast to widen to about 2.9% of GDP in fiscal year 2015/16 from 1.9% in 2014/15.

Timor-Leste

Growth of the non-oil economy rebounded to 7.1% in 2014 from 5.4% in 2013. The non-oil economy is dominated by government spending; current expenditures are about twice those for capital expenditures. The economy as a whole continued to contract as oil production declined. Even before the recent drop in global oil prices, Timor-Leste's oil revenue was falling after having peaked at about $3.9 billion in 2012. The current account surplus shrank to about 24% of GDP in 2014 from 45% in 2013. Excluding revenues from the export of oil, there is a huge trade deficit; non-oil exports were estimated to be worth only $20 million, compared with imports into the country of $753 million in 2014. As government spending grew at a more sustainable pace, the rapid expansion in credit to the private sector and in imports also moderated.

In 2015, slightly higher growth of 6.5% is projected for the non-oil economy. Growth is expected to remain largely stable at 6.5% in 2016. There is some uncertainty to the forecast, however, as it depends significantly on the 2015 government budget, which was based on an oil price of $107 per barrel. The recent drop in global oil prices will have a significant impact on the overall economy. Medium-term growth will depend critically on efforts to diversify the economy and develop the private sector. Development of the agricultural sector is important in order to reduce reliance on imported food and support employment.

The Government has scaled back ambitious expenditure plans given the need to smooth fiscal spending over the long term to avoid a fiscal cliff. Investment income from the Petroleum Fund of Timor-Leste is expected to provide an ongoing income stream once hydrocarbon reserves are exhausted within a decade. That fund, which was established in 2005, was valued at $16.5 billion as of December 2014. The medium-term priority is to build human capital and infrastructure and develop sectors, such as agriculture, tourism and petrochemicals, in line with the national Strategic Development Plan 2011-2030.

Viet Nam

Economic growth accelerated to 6% in 2014 from 5.4% a year earlier, driven by strong exports and increased foreign investment on the back of stable macroeconomic conditions. Total investment grew by 8.9%, supported by increased investments made by manufacturers, such as major electronics firms from the Republic of Korea, while household final consumption grew by 6.1%; exports grew by 13.6%. On the supply side, expansion in industry and construction was relatively stronger than in services. While these figures may paint a picture of strong recovery compared with the weak growth in recent years, it is important to note that domestic demand remains subdued. The number of domestically owned businesses that have closed or suspended operations remains high. Credit growth also remained weak for most of the year, although rising to 12.6%, within the target band, in December 2014. Even in exports, the performance of foreign-investment firms was much stronger than that of domestically owned firms. Modest job growth of 0.8% was mainly in industry and construction.

In 2015 and 2016, growth is forecast to edge up to 6.1-6.2%, driven by exports and investment and possibly a mild recovery in household consumption and the domestically oriented sectors. Stable prices will continue to benefit consumers and businesses. Inflation has dropped from double-digits in 2011 to only 4.1% in 2014; it is expected to trend further downward to 2.5% in 2015. Viet Nam's crude oil exports will suffer from the drop in global oil prices. On balance, however, the welfare gains from lower inflation should offset the revenue shortfall. Moreover, the successful diversification of the manufacturing and export base over the past decade effectively mitigates the impact of oil price volatility. Tourist arrivals are also expected to recover, after being affected by a maritime territorial dispute with China in 2014. Most critical to the medium-term economic outlook is the ongoing restructuring of banks and State-owned enterprises and its impact on domestic private sector development.

In 2014, the central bank lowered its main reference interest rates and the ceiling on deposit rates to help banks lend at lower rates. The effectiveness of such measures, however, has been limited due to the still high share of non-performing loans, which had fallen in the course of 2014 but still remain high. The central bank is now directly facilitating the acquisition and mergers of a number of struggling banks, with a view to reducing by 50% the number of commercial banks over the next three years. Reform of State-owned enterprises is a related priority. The Government issued a comprehensive action plan to step up divestment of State-owned enterprises; 74 such enterprises went through equitization in 2013 and another 40 in the first half of 2014, including large State-owned enterprises, such as Vietnam Airlines and the Vietnam National Textile and Garment Group. With an improved sovereign risk rating, Viet Nam raised $1 billion in government bonds from international capital markets on favourable terms. The overall direction is towards fiscal consolidation and debt reduction.

5.3. Selected medium-term policy challenges

This section starts with a discussion of the ASEAN Economic Community, which will be formally established at the end of this year and mark a milestone in South-East Asia's journey towards closer integration. A discussion follows of three policy options for addressing the issues identified in the first section, namely macroprudential tools for managing household debt and real estate finance; fiscal reforms and regional financial cooperation for increasing infrastructure investment; and education and training and universal health care for a skilled and healthy labour force.

With the launching of AEC this year, countries should accelerate reforms in order to fully realize the potential welfare gains from integration. In 2007, the 10 ASEAN member countries committed to accelerating the integration process with the goal of forming a single market and production base by 2015. At the twenty-fifth ASEAN summit in November 2014, it was noted that 82.1% of the deliverables under the so-called AEC Blueprint had been achieved to date; it was agreed that the implementation of remaining measures would be fast-tracked, including those related to non-tariff barriers, the customs single window, and services and investment liberalization (see box 1.2 in chapter 1). Compared with tariff reductions, these remaining measures tend to require more domestic reforms and are arguably more challenging. However, the potential benefits are also larger; one study estimates that the welfare gains under AEC to be at least 5.3% of GDP, compared with 0.8% from the ASEAN Free Trade Area alone (Plummer and Chia, 2009).

Services and investment liberalization is understandably a sensitive issues as it could intensify competition for domestic market share; countries should, therefore, be adequately prepared. At the same time, appropriate liberalization can help diffuse sectoral best practices and technology among other countries, while deepening and broadening South-East Asia's production networks. With increased economies of scale, South-East Asian businesses will also be able to better compete against global multinationals. This is already happening across a variety of sectors, including aviation, banking, telecommunications and utilities. Malaysia and Singapore have a clear lead in many areas, but others are also active; for instance, Manila Water, a Filipino utility firm, is investing in Viet Nam while Thai food companies are investing in the Philippines.

Appropriate macroprudential tools can be used for managing household debt and real estate finance; other tools, such as stamp duties and structural policies, may also be needed. South-East Asian countries today enjoy financial stability due to prudent measures put into place following the 1997 Asian financial crisis. Recently, there has been renewed focus on macroprudential tools to contain the side effects of low interest rates and massive liquidity. As noted by the IMF, different tools have different effects and should be selected based on the specific objective (IMF, 2014). For instance, limits on loan-to-value ratios in essence imposes a minimum down payment, while limits on debt-service-to-income ratios restrict unaffordable increases in household debt. In contrast, sectoral capital requirements force lenders to hold extra capital against loans to a specific sector, thus discouraging heavy exposure to the sector. There are also hybrid/more tailored measures. For instance, higher risk weights or additional capital requirements can be imposed on mortgage loans with high loan-to-value ratios, as in the case of Malaysia, while stricter loan-to-value limits can be applied in order to differentiate speculators with multiple mortgage loans from first-time home buyers. Importantly, if house price booms are driven by increased demand from foreign cash inflows that bypass domestic credit intermediation, other tools, such as stamp duties, may be more effective, as in the case of Singapore. At the same time, given the low infrastructure stock and the rapid urbanization taking place in many countries, high house prices may also reflect supply bottlenecks. In such cases, structural policies, including urban planning and expansion of government-subsidized housing, would be needed.

South-East Asia should also tackle infrastructure investment from multiple angles, including fiscal reforms, public-private partnerships and regional financial cooperation. The sheer scale of infrastructure financing requirements calls for the mobilization of all possible sources and instruments. Political leadership and government capacity and coordination are critical for selecting and prioritizing the correct projects, allocating more budget for enhancing public infrastructure and then implementing those efforts, creating a pipeline of bankable projects and engaging the private sector and working through land acquisition and other barriers.

As highlighted in the *Survey* for 2014, strengthening of tax and non-tax revenues would also be important. Examples include Indonesia's elimination of petrol price subsidies, which released some $18 billion for infrastructure and other uses, and the country's land acquisition law; Malaysia's pipeline of infrastructure and industry projects under the Economic Transformation Programme, which includes the second line in its mass rapid transport system, the light rapid transport extension and the Kuala Lumpur-Singapore high-speed rail line; and the Philippines tax administration reform and the launch of more than 50 midsize public-private partnership projects.

At the same time, regional financial cooperation can support infrastructure investment by increasing the availability of stable and long-term funds and mobilizing regional savings, including foreign exchange reserves and assets held by institutional investors, such as pension funds and insurance companies. Examples include the ASEAN+3 Bond Market Initiative for developing local currency bond markets; and the ASEAN Infrastructure Fund, which is partly financed by central banks' foreign currency reserves. In the broader picture, the ability to recycle regional savings for regional investment will also depend on the availability of effective global and regional financial safety nets and the reform of the international monetary system.

The level and quality of education and vocational training is also important for reducing skills shortages. While most countries have achieved universal primary education, the quality of the education varies, with students in some cases completing primary education without having acquired basic literacy and numeracy skills. Given the skills required in a modern economy, secondary enrolment should be actively encouraged. Increased public spending on education should be accompanied by other measures, such as enhanced teachers' selection and training. Governments can also improve the range and types of technical and vocational education and training, including apprenticeships, other work-experience schemes and work-based learning to foster youth employment. Setting qualification references at national and regional levels can facilitate employment. For instance, Singapore has a national credentialing system to train individuals in key competencies that companies seek. In 2014, ASEAN endorsed the Qualifications Reference Framework, which enables comparison of the qualifications of skilled labour across ASEAN member countries, as part of the efforts to promote mobility. At the same time, greater progress is needed on the public health front.

Striking the right balance between breadth and depth is needed for universal health care. The 2013 ASEAN Declaration on Strengthening Social Protection called for collective progress towards universal health coverage. This requires advancing along three dimensions: (a) the breadth or extension of population coverage by insurance schemes; (b) the depth or the types of services that need to be provided, such as outpatient and inpatient services; and (c) the height or the financial risk protection, such as co-payments (Tangcharoensathien and others, 2011). Striking a balance within the financial constraints is not easy, and countries can learn from such successful cases as Thailand, which spends less than 5% of GDP on health but is viewed largely as having achieved universal coverage of health services. Prepayment and risk-pooling schemes can expand coverage and reduce out-of-pocket payments (WHO, 2009). Examples include the Philippine government-owned health insurer, whose coverage rose from 62% of the population in 2010 to 81% in 2013; and Viet Nam's government-subsidized health insurance premiums for vulnerable groups.

Annex I. Results of probit regressions: dependent variable – product innovation

Factors	Armenia	Azerbaijan	Kazakhstan	Kyrgyzstan	Russian Federation	Tajikistan	Uzbekistan
Sector 1	0.391 (0.192)		0.205 (0.611)		0.411** (0.013)		-0.166 (0.615)
Sector 2	0.092 (0.863)		1.028 (0.105)		0.089 (0.599)		0.052 (0.883)
Sector 3	0.034 (0.922)		-0.463 (0.246)		-0.113 (0.514)		0.024 (0.943)
Sector 4	0.418 (0.227)		-0.042 (0.930)		-0.034 (0.825)		0.912*** (0.006)
Sector 5	0.621* (0.054)		-0.523* (0.084)		0.236 (0.182)		0.670** (0.037)
Sector 6	0.725*** (0.000)		0.157 (0.452)		0.194 (0.218)		-0.307 (0.150)
Sector 7	-0.178 (0.511)		1.018 (0.153)		0.471 (0.225)		0.454 (0,130)
Small					-0.274* (0.022)		
Medium					-0.099 (0.356)		
Group	0.800** (0.023)	0.460 (0.107)			0.339** (0.023)		
Fown		0.128 (0.714)	0.281 (0.453)	0.545** (0.039)			0.186 (0.412)
Age							0.007* (0.099)
QMS			0.138 (0.532)		0.018 (0.878)		
Flic	0.392 (0.201)		0.316 (0.412)	0.352 (0.275)		0.249 (0.334)	
RDinput	0.633*** (0.001)		1.211*** (0.000)	0.912*** (0.001)	0.862*** (0.000)	0.674*** (0.002)	0.912* (0.077)
Training	0.861** (0.025)		0.267 (0.361)	0.981** (0.014)	0.348*** (0.004)	0.498* (0.083)	0.575* (0.068)
Skillwork	0.009*** (0.000)	0.013** (0.022)	0.004 (0.179)			0.005* (0.061)	
Manager							0.017** (0.041)
Domcompet	0.218 (0.386)				0.228 (0.078)	0.282 (0.129)	
Forcompet			0.465 (0.120)	0.425* (0.073)	0.094 (0.474)	0.481** (0.035)	
Customers	0.117 (0.589)		0.285 (0.258)		0.188 (0.150)		
Exports					-0.035 (0.841)		
Sub					0.221 (0.270)	-0.047 (0.882)	
Nonbankfin		-0.017*** (0.000)	-0.005* (0.056)				
Number of firms	374	171	264	235	1004	360	361
LR statistics (prob.)	77.774 (0.000)	26.746 (0.000)	58.198 (0.000)	39.848 (0.000)	154.518 (0.000)	30.948 (0.000)	50.724 (0.000)

Source: Gui-Diby (forthcoming, a).

Note: P-values are in parentheses under the estimated coefficients.
*, **, and *** refer to significance levels of, respectively, 10%, 5%, and 1% .

Annex II. List of variables used in the regression analyses

Categories and code of variables	Label	Description
Prod_innov	Product or service innovation	Dummy variable = 1 if firm innovates; 0 otherwise
Proc_innov	Process innovation	Dummy variable = 1 if firm innovates; 0 otherwise
Sector	*Manufacturing* *Services*	Five dummy variables for: 1=food; 2=textiles and garments; 3=chemicals, plastics & rubber, and non-metallic mineral products; 4=basic metals, fabricated metal products, and machinery and equipment; 5=electronics and other manufacturing Two dummy variables for: 6=Retail; 7=Hotel and restaurants.
Size	Firm size	Two dummy variables for: 1=small (5-19), 2=medium (20-99), 3=large (100+)
Group	Part of a larger group	Dummy variable if firms belongs to a larger group; 0 otherwise
Fown	Foreign ownership	Dummy variable = 1 if percentage >= 10%, 0 otherwise
Age	Firm age	Numerical variable: computed according to first year of operation
QMS	Quality certification	Dummy variable=1 if firms holds an internationally-recognized quality certification; 0 otherwise
Flic	Usage of foreign licensed technology	Dummy variable=1 if firm uses foreign licensed technology; 0 otherwise
RDinput	R&D expenditures	Dummy variable
Training	Training of staff	Dummy variable
Skillwork	Percentage of labour force with university degree	Percentage
Manager	Manager's experience in the sector	Numerical
Domcompet *Forcompet* *Customers*	Domestic competitors Foreign competitors Customers	Grades with the following values to reflect the importance: 0, ¼, ½, and 1
Exports	Exports	Dummy variable equal to 1 if percentage of exports is above 20%; 0 otherwise
Sub	Subsidies	Dummy variable=1 if firm received subsidies from government or European Union; 0 otherwise
Nonbankfin	Proportion of purchase of fixed assets financed by	Internal funds or retained earnings; or owner's contribution; or issues of new equity shares; credit from suppliers and advances from customers; or other sources such as moneylenders, friends, relatives, non-banking financial institutions

Endnotes

1 ASEAN Plus Three refers to the ASEAN countries plus China, Japan and the Republic of Korea.

2 For details of this phenomenon, see the information contained in a number of online publications available from http://esa.un.org/unpd/wup/.

3 The Hong Kong dollar is pegged to the United States dollar, which requires Hong Kong, China to follow the United States Government's monetary stance in setting policy rates.

4 To hedge against exchange rate fluctuations, the firms set a buffer markup and adjust the margins rather than passing the price changes on to consumers. This also explains the record-high corporate profits seen in 2014. For more details, see Amiti, Itskhoki and Konings (2014).

5 The law requires full disclosure of budgetary and financial information related to all public entities.It is expected to curb off-budget expenditure, which in 2013 amounted to more than 8% of GDP.

6 More than 300 people died, many of them students, when a ferry capsized off the coast of the Republic of Korea,near Byeongpungdo, on 16 April 2014.

7 Details are available (in the Korean language) in *KDI Economic Outlook 2014*. Available from www.kdi.re.kr/report/report_class_e2.jsp?pub_no=13865.

8 For more details, see www.sids2014.org/index.php?menu=1537.

9 Exports from the LNG project are not included here due to the non-availability of data at the time of reporting. After adjustment, the export value in 2014 should be much higher.

10 ADB estimates that the hydropower sector has an estimated potential of generating 30,000 megawatts, while the installed generating capacity is about 1,500 megawatts. The Government plans to add another 10,000 megawatts by 2020. For further information, see ADB (2013).

11 Currently, firms with more than 100 employees require government approval for job retrenchment. Although this is a rigid condition, a balance must be struck between protecting workers and promoting the efficiency of the labour market. To promote job-market flexibility, the Government plans to facilitate access to savings with the Government when workers change jobs.

12 Workers' remittances have helped to raise household incomes in Nepal but they do not help to promote agricultural yields because the funds are not generally invested in productivity-enhancing equipment and techniques. For details, see Tuladhar, Sapkota and Adhikari (2014).

13 For example, Pakistan's decision to increase power tariffs in October 2014 was reversed only days after it had been announced. Opposition may come from the public's perception that the rich benefit more from public subsidies than the poor. According to Trimble, Yoshida and Saqib (2011), the share of electricity subsidies received by the richest 20% of the population was about 29% in 2011.

14 For more details, see ESCAP (2015a).

15 For more details, see Gunatilake and Roland-Holst (2013);Pargal and Banerjee(2014);and Speakman(2012).

16 According the central bank, the share of non-performing loans fell from 4.7% to 3.9% in the course of 2014. Unofficial estimates are much higher; for instance, Moody's estimate was at least 15% of total bank assets.

17 Estimates for South-East Asia range from $60 billion annually (ADB, 2009) to about $7 trillion through 2030 (Woetzel and others, 2014). Woetzel and others (2014) estimate, which is uses a global benchmark of 70% of GDP for infrastructure stock, includes housing as well as transport, energy, ICT and water infrastructure.

18 See ESCAP (2013a), box 2.5.

3

REALIZING INCLUSIVE GROWTH

Economic growth in the Asia-Pacific region has been quite spectacular over the last few decades as real incomes per capita on average have doubled since the early 1990s. That growth has lifted millions of people out of extreme poverty and has enabled the region as a whole to attain – before the 2015 deadline – the first target under the Millennium Development Goal of eradicating extreme poverty and hunger by halving the proportion of people whose income is less than $1 a day.

Economic growth is a critical element in the development process. It creates opportunities for the enhanced well-being of people, through for example the generation of employment opportunities, which in turn contributes to the process of reducing poverty. Moreover, as employment expands and incomes increase, Governments are able to raise more resources – through such measures as taxation – for investment in additional production, which fosters further growth and development, thereby creating a virtuous circle that enables acceleration of the poverty reduction process.

"Development", however, encompasses much more than increasing the levels of income and reducing poverty. It is a multidimensional concept, as highlighted in the first *Human Development Report*: "The purpose of development is to offer people more options. One of their options is access to income [….] But there are other options as well, including long life, knowledge, political freedom, personal security, community participation and guaranteed human rights" (UNDP, 1990, p. iii).

In this context, articulation of the Millennium Development Goals has been an important milestone in the development discourse as those Goals highlight the importance of social and economic factors through the inclusion of, for instance, health, education and gender-related dimensions. Overall, however, progress towards achieving the Goals has been uneven within as well as between countries in the region. An estimated 743 million people in the region still remain trapped in extreme poverty. In addition, gaps in development achievements have widened between rural and urban sectors in general, and between the “haves” and “have-nots” in particular, especially in the major developing countries in the region.

The year 2015 is a watershed in global policymaking in the pursuit of inclusive and sustainable development as it marks the deadline for achieving the Millennium Development Goals, and it is expected to be the year when the United Nations launches a set of sustainable development goals to provide a framework for the formulation of future development policies. In that context, now is an opportune time to take stock of just how inclusive economic growth has been in the Asia-Pacific region. For this purpose, the discussion in this chapter, while highlighting the region’s achievements in terms of economic growth and poverty reduction, points to trends that have taken place in individual countries. Those trends are reflected in important indicators of development other than just economic growth and poverty reduction. This is done to emphasize that social and environmental factors are also important elements that need to be considered in tandem with economic factors when determining just how inclusive such growth has been. Although noteworthy improvements have been made across countries in expanding access to health and education, significant divergence exists in the achievements made within countries on, for example, gender issues across the rural and urban sectors and between regions. Furthermore, progress that has taken place in the economic, social and environmental dimensions has often disproportionately benefited better off people.

In this chapter, it is argued that *inclusiveness* is essentially an unobserved multidimensional concept. In presenting a measure of inclusiveness that combines multidimensional economic, social and environmental indicators, an index is made available to enable measurement of just how inclusive growth has been in the region since the 1990s. This measurement is carried out to draw attention to the fact that a broader approach than one based on economic growth only is important when it comes to assessing people’s well-being. Moreover, based on trend analysis of the three dimensions that underpin inclusiveness (*economic, social* and *environmental*), policies are identified that have contributed to making growth more inclusive, that is, policies that would enable the benefits of economic growth to be spread more evenly within countries. In doing so, attention is drawn, for instance, to the importance of reenergizing the development of the rural sector through rural industrialization. It is also argued that the developmental role of monetary and fiscal policy needs to be strengthened.

1. TRENDS AND PATTERNS OF INCLUSIVE GROWTH IN THE REGION

Although GDP growth in developing economies has been subdued in the Asia-Pacific region since the 2008 global financial crisis, it has been spectacular to the extent that levels of real income per capita have on average doubled since the early 1990s. In countries such as Bhutan, Cambodia and Viet Nam, real income per capita has tripled, while in China it has grown more than sevenfold since 1990. In contrast, in the economies of Brunei Darussalam, Georgia, Kyrgyzstan and Palau real per capita income has decreased by up to 14%, while in Tajikistan it has contracted by a third (annex table I).

Despite this performance, the developing Asia-Pacific region is characterized by a large degree of divergence in social and in economic development indicators. For instance, income per capita ranges from $409 per person in Nepal to almost $37,000 in Singapore, a tremendous gap that has in fact been growing since the 1990s. Economies in the region are also characterized by large differences in poverty and inequality. The question thus arises as to whether or not growth has been inclusive. Addressing this issue requires, however, a clear definition of “inclusiveness”. While a number of definitions have been applied to the concept of inclusiveness (see box 3.1), in this chapter inclusive growth is viewed as a multidimensional concept.

Thus, the terms income, income insecurity, poverty and inequality relate to an *economic* dimension of inclusiveness. With the current focus of the development community being on sustainable development, inclusiveness should also capture development achievements relating to *social* and *environmental* indicators. Also to be considered under the term inclusiveness should be the nature of policies for enhancing opportunities to access public goods. For instance, dimensions that should be addressed include “limited or lack of access to education and other basic services; increased morbidity and mortality from illness; homelessness and inadequate housing; unsafe environments; and social discrimination and exclusion” (United Nations,1995).

Box 3.1. Defining inclusiveness

To address the issue of inclusiveness of growth, it is necessary first to identify, understand and define the concept. While the term "inclusive growth" has been widely used in recent years by Governments, international organizations and other stakeholders, consensus is still lacking on what constitutes a clear understanding of the concept. For instance, when measuring and determining the inclusiveness of growth, Anand, Mishra and Peiris (2013) considered economic growth as pro-poor as long as the extremely poor benefit.[a] Dollar and Kraay (2002) defined growth as being inclusive when the income of the bottom quintile does not decrease. Balakrishnan, Steinberg and Syed (2013) integrated equity and growth in a unified measure so that they could consider income growth and income distribution. In so doing, they found that growth was not inclusive in Asia. According to de Mello and Dutz (2012), "…inclusiveness goes beyond poverty and income distribution and encompasses other dimensions, such as well-being, voice in the political process and participation in social life…". Khan (2012) argued: "Growth is inclusive if it supports high levels of employment and rising wages".

Among the various definitions that have been used by Governments and institutions, that of the Indian Planning Commission is quite comprehensive. In its Eleventh Five Year Plan, it defined inclusive growth as "…growth that reduces poverty and creates employment opportunities, access to essential services in health and education especially for the poor, equality of opportunity, empowerment through education and skill development, employment opportunities…, environmental sustainability, recognition of women's agency and good governance".[b] By encompassing economic, social and environmental aspects of development, this definition captures the essence of the commitments that representatives of Member States agreed in the outcome document[c] of the United Nations Conference on Sustainable Development, held in Rio de Janeiro, Brazil, in June 2012. In that document, entitled The future we want, the signatories clearly committed to ensuring the promotion of an economically, socially and environmentally sustainable future for the planet.

[a] Under the relative definition, growth is pro-poor if and only if the income of poor people grows at a faster rate than that of the population as a whole. Under the absolute definition, any increase in the income of the poorest is considered pro-poor.
[b] See Government of India Planning Commission, *Eleventh Five Year Plan (2007-2012)*, vol. 1 (Inclusive Growth), chap. 1, para. 1.9. Available from http://planningcommission.nic.in/plans/planrel/fiveyr/welcome.html.
[c] See General Assembly resolution 66/288.

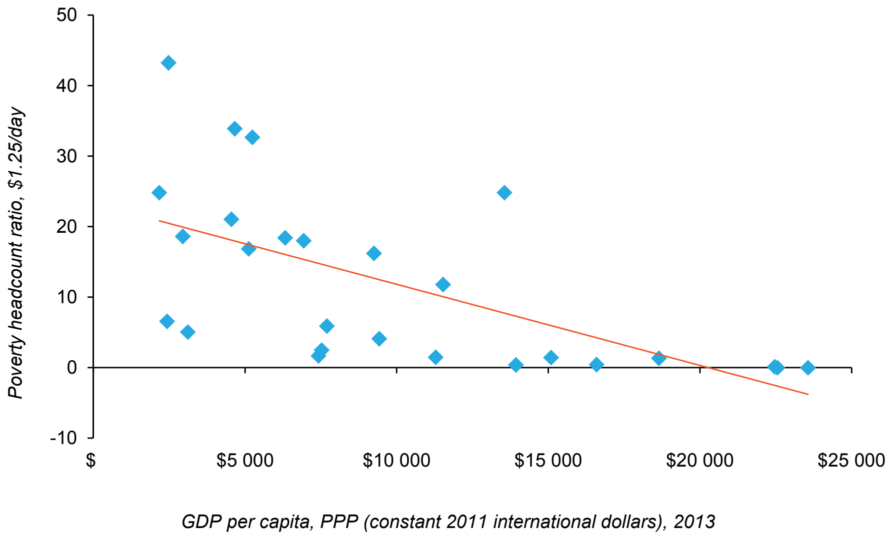
Overall, the concept should be sufficiently broad to capture, for instance, access to energy services and environmental goods, such as clean air and water. The inclusion of a broader range of variables would therefore contribute to a better understanding of inclusiveness that could further strengthen the sustainability of economic growth. Moreover, the concept of inclusiveness should capture output variables, as opposed to input variables, such as policies. Broadly, this chapter defines inclusiveness in terms of the following broad social objectives: (a) increasing the average standard of living of the population (captured here by average real income per capita); (b) reducing income inequality; (c) reducing levels of extreme poverty and (d) expanding and broadening equality in opportunities, such as access to public goods, including health and education services. Achievement of these social objectives should lead to an increase in people's well-being, which is the ultimate objective of any society. In the following subsections, *economic* and *social* inclusiveness are discussed before considering the wider concept of inclusiveness with respect to *environmental* factors.

1.1. ECONOMIC INCLUSIVENESS

1.1.1. Inclusiveness and poverty in income

Economic growth should be broad-based and inclusive, enabling all segments of the population to benefit from such growth while incorporating the needs of the extremely poor and vulnerable. The elimination of extreme poverty should be one of the primary social objectives of all Governments, without which inclusive growth cannot be realized. In this regard, economic growth in the Asia-Pacific region has been quite successful: whereas in 1990 more than 1.6 billion people, equivalent to 51% of the region's population, were living in extreme poverty, by 2011 the incidence of extreme poverty had dropped to about 18% of the population. As previously mentioned, when considered as a whole the region has already attained the Millennium Development Goal of reducing extreme poverty by half. Nonetheless, it should be remembered that about 743 million people in the Asia-Pacific region are still trapped in extreme poverty.

Figure 3.1. Income levels and extreme poverty in developing Asia-Pacific economies in 2013



Source: ESCAP, based on World Bank, World Development Indicators. Available from http://data.worldbank.org/data-catalog/world-development-indicators.

While poverty rates are uneven across the region, the incidence of absolute poverty decreases markedly with income per capita (figure 3.1). The poverty rate exceeds 30% in only 3 countries, Bangladesh, India and the Lao People's Democratic Republic, compared with more than 12 countries at the beginning of the 1990s. Moreover, extreme poverty has all but been eradicated in Azerbaijan, Kazakhstan, Malaysia, the Russian Federation and Thailand.

In fact, rates of extreme poverty have declined in almost all countries in the region (table 3.1). In most economies, when using the $1.25 per day poverty line, the rates of extreme poverty had already declined by half or more than half by 2010, with the notable exceptions of Bangladesh, India, the Lao People's Democratic Republic and the Philippines. However, although extreme poverty has declined significantly in the region, poverty measured at the $2 poverty line is still very high. In India, 68.8% of the population was living below that line in 2010; in Nepal, 6 out of 10 persons were living below that line in 2010.

Despite the success achieved in reducing levels of extreme poverty in the Asia-Pacific region, large divergences exist in poverty rates within countries, such as significant gender differences in poverty rates (see box 3.2). In addition, there is a large divide between rural and urban areas, with extreme poverty in rural areas usually being higher than in urban areas. For instance, the incidence of extreme poverty in urban China is almost negligible while in rural parts of the country it is quite high (figure 3.2). Thus, although China's performance in reducing poverty is widely applauded, its impressive economic growth has to some degree bypassed the people in rural areas, as witnessed by a rural-urban poverty gap that is much wider than that in India. This may be due to the strict control of rural-to-urban migration, which has reinforced segmentation of the rural and urban sectors in China (Fan, Chen-Kang and Mukherjee, 2005). In contrast, while the rural-urban gap in India is much lower than that in China, poverty rates are higher in India than in China. Arguments that have been put forward to explain this phenomenon point to the comprehensive land reforms that took place in China after the revolution of 1949. That incident altered the asset distribution in the country, whereas in India significant land reforms involving substantial redistribution of assets did not take place to the same extent (Ghosh, 2010). Furthermore, growth rates have been significantly higher in China, where they averaged 9.7% annually between 1990

Table 3.1. Extreme poverty ($1.25/day PPP) rates and their changes

Country	Poverty rate (percentage of population) in early 1990s	Latest poverty rate (percentage of population)	Decline in percentage points	Change
Armenia	17.5	2.5	15.0	-85.9%
Azerbaijan	16.3	0.4	15.8	-97.4%
Bangladesh	70.2	43.3	27.0	-38.4%
Bhutan	26.2	1.7	24.6	-93.7%
Cambodia	44.5	18.6	25.9	-58.2%
China	60.2	11.8	48.4	-80.4%
Fiji	29.2	5.9	23.3	-79.8%
Georgia	4.7	18.0	-13.3	282.0%
India	49.4	32.7	16.7	-33.8%
Indonesia	54.3	16.2	38.1	-70.1%
Iran (Islamic Republic of)	3.9	1.5	2.4	-62.3%
Kazakhstan	4.2	0.1	4.1	-97.4%
Kyrgyzstan	18.6	5.0	13.6	-73.0%
Lao People's Democratic Republic	55.7	33.9	21.8	-39.2%
Malaysia	1.6	0.0	1.6	-100.0%
Maldives	25.6	1.5	24.1	-94.2%
Nepal	68.0	24.8	43.2	-63.5%
Pakistan	64.7	21.0	43.7	-67.5%
Philippines	30.7	18.4	12.3	-40.0%
Russian Federation	1.5	0.0	1.5	-100.0%
Sri Lanka	15.0	4.1	10.9	-72.6%
Tajikistan	49.4	6.6	42.8	-86.7%
Thailand	11.6	0.4	11.2	-96.7%
Turkey	2.1	1.3	0.8	-36.2%
Turkmenistan	63.5	24.8	38.7	-60.9%
Viet Nam	63.7	16.9	46.9	-73.6%

Source: ESCAP statistics and World Bank, World Development Indicators. Available from http://data.worldbank.org/data-catalog/world-development-indicators.

and 2013, than in India, where they averaged 6.4%. By contrast, in Indonesia the incidence of poverty is slightly higher in urban areas than in rural areas.

In addition to the urban-rural divide, there is also a significant gap in poverty rates across regions and ethnicities in several countries. For instance, in India, poverty at the state level differs widely; in Kerala, only 7.1% of the population are poor compared with 39.9% in Chhattisgarh. In Central Nepal, the poverty rate is less than half that in the Far-Western Development Region.

1.1.2. Inclusiveness and income inequality

Economic growth is necessary but not sufficient for realizing inclusive growth. Indeed, despite the impressive progress made in reducing extreme poverty in the region, increases in levels of real income have not always been distributed evenly within countries. On the contrary, income inequality, as measured by the Gini coefficient, has increased in many countries in the region, especially in the major developing countries. As reported in previous issues of the *Survey*, between the 1990s

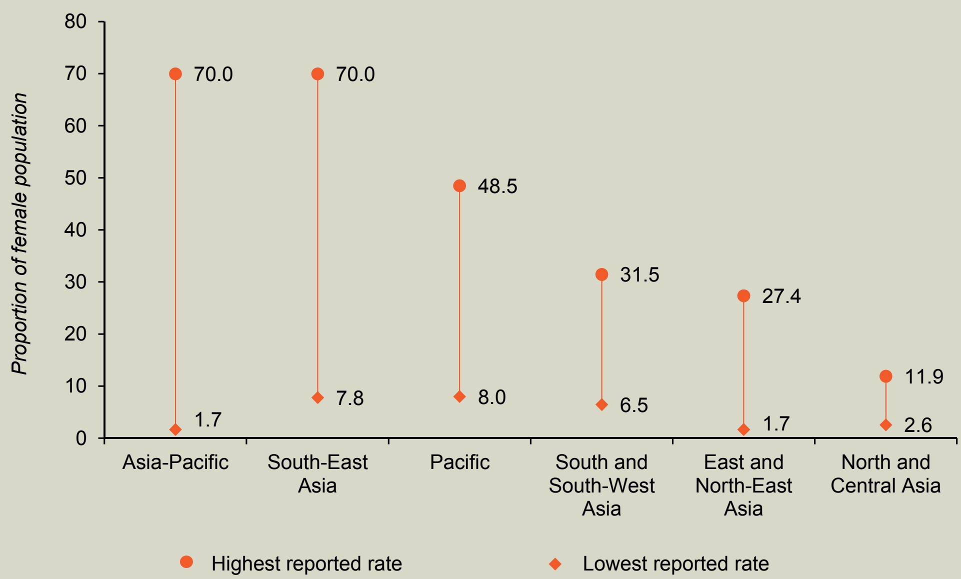
Box 3.2. Women and poverty

In spite of the remarkable achievements made in reducing poverty in the Asia-Pacific region, poverty among women is usually higher than among men, largely as a result of systemic vertical and horizontal discrimination in the labour market. In spite of improvements in educational attainment, women's labour-force participation remains significantly lower than that of men. Access to economic opportunity is limited also by cultural norms, discriminatory laws and the lack of supportive infrastructure and services that would facilitate women's labour-force participation.

As information on poverty is usually collected at the household, rather than at the individual, level, there is a dearth of sex-disaggregated data. However, for five economies that submitted information to ESCAP for the 2014 Asia-Pacific Survey on Progress in Implementation of the 12 Critical Areas of Concern of the Beijing Platform for Action, it was shown that the proportion of the female population living in extreme poverty ranged from 0.4% to 43.3% (ESCAP, forthcoming, b).

That survey also revealed that across the Asia-Pacific region the reported proportion of female populations at the national level living in poverty ranged from a low of 1.7% (Macao, China, 2012) to a high of 70% (Timor-Leste, 2013) (see figure A below). In their observations of poverty among women and girls, the respondents noted the particular vulnerability of female-headed households and of sole-parent households, the majority of which are composed of women. They further reported that greater proportions of women than of men fall within low-income brackets or within "disadvantaged populations".

Figure A. Reported range of proportion of female population living below national poverty lines, by ESCAP subregion



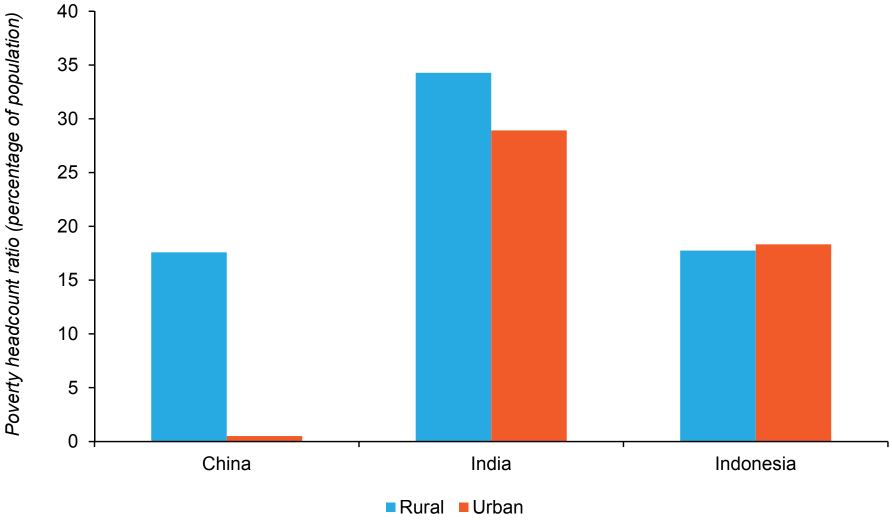
Source: ESCAP (forthcoming, b).

Note: Data for the Pacific (Kiribati, Nauru, Republic of Palau and Tuvalu) from the period 2005-2012; for South-East Asia (Myanmar, Philippines, Thailand and Timor-Leste) from the period 2009-2012; for East and North-East Asia (China; Hong Kong, China; Macao, China; and Mongolia) from 2012/13; for North and Central Asia (Azerbaijan, Kazakhstan, Kyrgyzstan and the Russian Federation) from the period 2012-2014; and for South and South-West Asia (Bangladesh, Bhutan, Sri Lanka and Turkey) from the period 2009-2013.

and 2014, the population-weighted mean Gini coefficient for the entire region rose from 33.5 to 37.5. Thus, for the region as a whole, growth has not been inclusive if considered in terms of income inequality, as measured by the Gini coefficient. In a recent report, it was estimated that, if inequality had remained stable in those economies where it actually increased between 1990 and 2010, an additional 240 million persons in the region would have been lifted out of poverty.

In some countries, the Gini coefficient of income inequality has increased considerably since the 1990s, including in the region's larger economies,

Figure 3.2. Poverty headcount ratio in urban and rural sectors, selected economies in Asia and the Pacific, in 2010



Source: Kakwani (2014).

namely China, India and Indonesia, whereas the Gini coefficient has decreased quite significantly in Kyrgyzstan, the Russian Federation and Thailand (table 3.2). The Gini coefficient exceeds 40 in China, Fiji, Georgia, Malaysia, the Philippines, the Russian Federation and Turkey.

Table 3.2. Gini coefficients for selected Asia-Pacific countries, 1990-2012

Country	1990	2012	Change
Azerbaijan	35.0	33.7	-1.3
Bangladesh	27.6	32.1	4.5
Cambodia	38.3	36.0	-2.3
China	32.4	42.1	9.6
India	30.8	33.9	3.1
Indonesia	29.2	38.1	8.9
Iran (Islamic Republic of)	43.6	38.3	-5.3
Kazakhstan	32.7	29.6	-3.6
Kyrgyzstan	53.7	33.4	-20.3
Lao People’s Democratic Republic	30.4	36.7	6.3
Malaysia	47.7	46.2	-1.4
Mongolia	33.2	36.5	3.3
Pakistan	33.2	30.0	-3.2
Philippines	43.8	43.0	-0.8
Russian Federation	48.4	40.1	-8.3
Sri Lanka	32.5	36.4	3.9
Thailand	45.3	39.4	-5.9
Turkey	41.5	40.0	-1.5
Viet Nam	35.7	35.6	-0.1

Source: ESCAP statistics.

While in almost all countries with available data, growth of per capita incomes accelerated in the last decade; however, income inequality also increased in many of them (annex table II). A widely observed phenomenon in the world is that inequality in urban areas is higher than in rural areas. This is true for both India and Indonesia. However, the opposite is the case for China where rural inequality is much higher than urban inequality (table 3.3), suggesting that the rural areas of China have been left out of the country's otherwise very fast growth path.

The Gini coefficient is quite sensitive to changes in the middle of the income distribution, but less sensitive to changes at the extreme ends of the distribution (Atkinson, 1970). A more policy-relevant measure therefore may be to look at the income share that is held by the different population quintiles and to compare the top and bottom income quintiles.

In comparing the share of income held by the top quintile (20%) to that of the bottom quintile in countries and tracing how this ratio has evolved since 1990, a mixed picture emerges in the Asia-Pacific region. Data from 28 countries in the region show that the income share of the top quintile relative to that of the bottom quintile increased in 12 countries when comparing the 1990s with the period 2000-2012. In addition, in almost all of these 12 cases, except for Turkey and Viet Nam, the richest quintile was able to increase its share in national income, while the share of the lowest quintile declined. This pattern of a worsening of relative income shares between the top and bottom quintiles also took place in the region's more populous economies, including Bangladesh, China, India and Indonesia. In China, the ratio has doubled since 1990; in 2009, the top quintile accounted for 10 times more income than the lowest quintile, which placed China within the 5 countries in the region with the worst income distribution between quintiles (figure 3.3).

Nevertheless, in many countries the income distribution between the top and bottom quintiles has improved, with large declines in North and Central Asia, such as in Armenia, Kyrgyzstan, the Russian Federation and Uzbekistan. The largest decline in the income distribution ratio was observed in Maldives, where it dropped steeply from a massive 46.6 in 1998 to less than 7 in 2004.

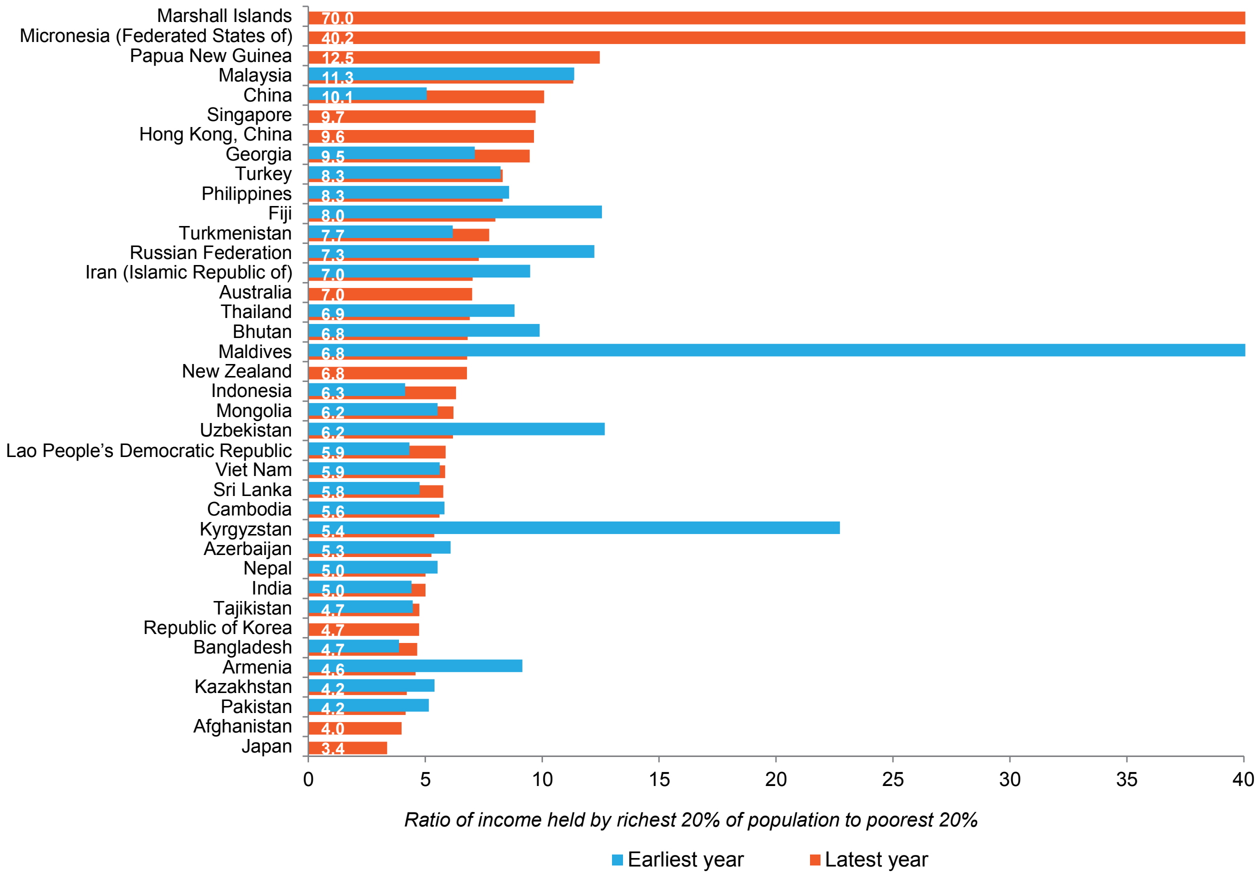
Growth and income inequality. Overall while there is no strong evidence in the economic literature that growth affects income inequality or that income inequality affects growth, it has been generally concluded that high initial inequality is weakly associated with lower later growth. One reason for the lack of a clear relationship between growth and equality may be that growth rates are too volatile to give meaningful results; therefore, growth periods should be looked at (Pritchett, 2000). Moreover, while changing inequality – in either direction – leads to lower growth (Banerjee and Duflo, 2003), this could be because growth and inequality appear to derive from common underlying causes (Lundberg and Squire, 2003). However, recent research suggests that lower inequality may drive growth and enable societies to enjoy longer periods of economic expansion (Ostry, Berg and Tsangarides, 2014). Thus, high inequality can contribute to greater social, economic and political instability; when incomes are distributed more unevenly, the ruling classes may extend more effort in protecting their wealth and strengthening rent-seeking activities than in generating inclusive patterns of growth. Such a situation may undermine the quality of governance, but could also increase pressure for implementing inefficient, populist policies.

Table 3.3. Rural and urban inequality divide, selected countries, 2010

Country	Gini index	
	Rural	Urban
China	40.6	35.7
India	30.0	39.3
Indonesia	31.5	38.1

Source: Kakwani (2014).

Figure 3.3. Ratio of income of richest to poorest quintiles, selected Asia-Pacific economies, 1990-2012



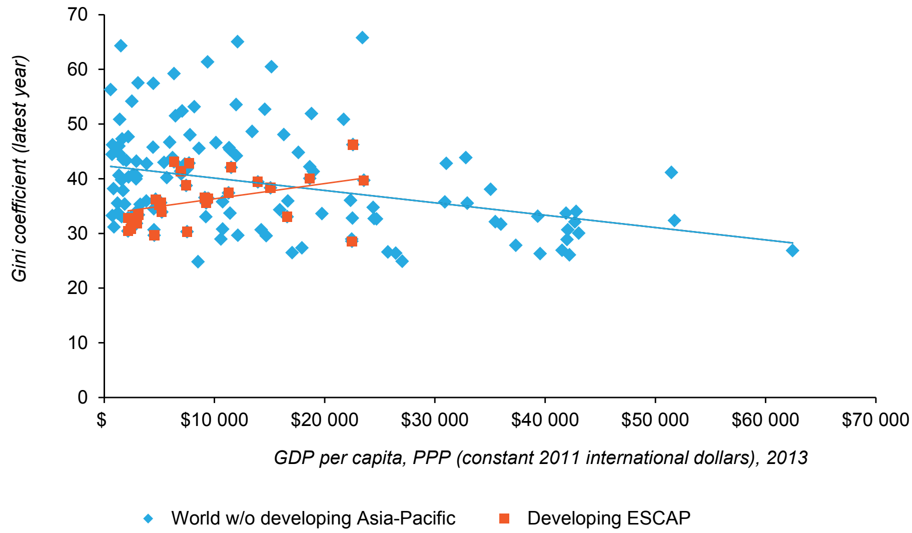
Source: ESCAP, based on World Bank, World Development Indicators. Available from http://data.worldbank.org/data-catalog/world-development-indicators.

Note: Periods compared are Armenia (1996-2010); Azerbaijan (1995-2008); Bangladesh (1992-2010); Bhutan (2003-2012); Cambodia (1994-2009); China (1990-2009); Fiji (2003-2009); Georgia (1996-2010); India (1994-2010); Indonesia (1990-2011); Islamic Republic of Iran (1990-2005); Kazakhstan (1993-2009); Kyrgyzstan (1993-2011); the Lao People's Democratic Republic (1992-2008); Malaysia (1992-2009); Maldives (1998-2004); Mongolia (1995-2008); Nepal (1996-2010); Pakistan (1991-2008); the Philippines (1991-2009); the Russian Federation (1993-2009); Sri Lanka (1991-2010); Tajikistan (1999-2009); Thailand (1990-2010); Turkey (1994-2010); Turkmenistan (1993-1998); Uzbekistan (1999-2003); and Viet Nam (1993-2008). For those countries with only one period observed: Afghanistan (2008); Australia (1994); Hong Kong, China (1996); Japan (1993); the Republic of Korea (1998); Marshall Islands (1999); Federated States of Micronesia (2000); New Zealand (1997); Papua New Guinea (1996); and Singapore (1998).

In the past, it was assumed that the relationship between growth and inequality followed an inverted U shape, or what has come to be known as the Kuznets curve. The common interpretation was that, at low levels of income, inequality rises as people move from low-productivity agriculture to the more productive industrial sector, where average income is higher and wages are less uniform. As society matures and becomes richer, the underlying assumption is that the urban-rural gap is reduced and social transfers, including old-age pensions, unemployment benefits and the like, lower inequality (Kuznets, 1955). Thus, market forces first increase and then decrease economic inequality as an economy develops. However, the experience in the Asia-Pacific region confirms the literature, in which it is argued that the Kuznets curve does not reflect a robust relationship: although inequality is negatively correlated with GDP per capita at the global level, this is not so when looking only at developing countries in the region (figure 3.4).

For one, it is not evident that the relevance of the Kuznets curve, which was extrapolated from cross-sectional data, is valid for time-series data. Indeed, some have argued that new international panel data with consistent time-series data for a large number of countries show no evidence of a Kuznets curve. Rather, these data show that inequality can decline in low-income countries and increase in high-income countries (Gallup, 2012).

Figure 3.4. Income levels and inequality around the world



Source: ESCAP, based on World Bank, World Development Indicators. Available from http://data.worldbank.org/data-catalog/world-development-indicators.

For instance, Frazer (2006) found examples of low-income countries with significantly decreasing inequality, such as India until its per capita GDP passed $1,700, whereas others, such as the Republic of Korea, have achieved considerable advances in per capita GDP despite experiencing relatively small changes in inequality. Indeed, it has been argued that, while the concept underlying Kuznets' hypothesis is correct – that inequality follows from structural change in economies – identification of this one particular structural change is too simplistic (Galbraith, 2010). For instance, during the three decades up to 1990 several economies in East Asia experienced rapid economic growth and declining inequality, a phenomenon that has been described as the "East Asian miracle", due to the combination of fundamentally sound development policies (a stable macroeconomic environment) and systemic government intervention to foster development. This trend changed starting in the late 1980s, coinciding with the introduction of deregulation, privatization, globalization and pro-cyclical macro policies, which processes, though conferring benefits, have led to greater inequality.

1.1.3. Inclusiveness and employment

Poverty and inequality are important elements of the multidimensional concept of *economic inclusiveness*. Other important economic factors include the availability of productive and decent employment, which is a decisive factor in whether a person can be lifted out of poverty and whether economic growth reduces income inequalities. Indeed, the lack of productive employment is one of the major reasons for the high incidence of poverty in many developing countries, whereas in many countries that successfully achieved both growth and equity, abundant employment opportunities had been created for the poor. Labour-intensive industrial expansion was the main vehicle for achieving this result in the Republic of Korea, for example, where light industries already produced labour-intensive goods in the 1960s and where subsequent investment in infrastructure helped to reduce unemployment substantially (Kniivilä, 2007). To reduce the risk of being trapped in a low-wage, low-productivity but labour-intensive development stage, countries need to strengthen the link between wages and productivity through appropriate wage and labour market policies.

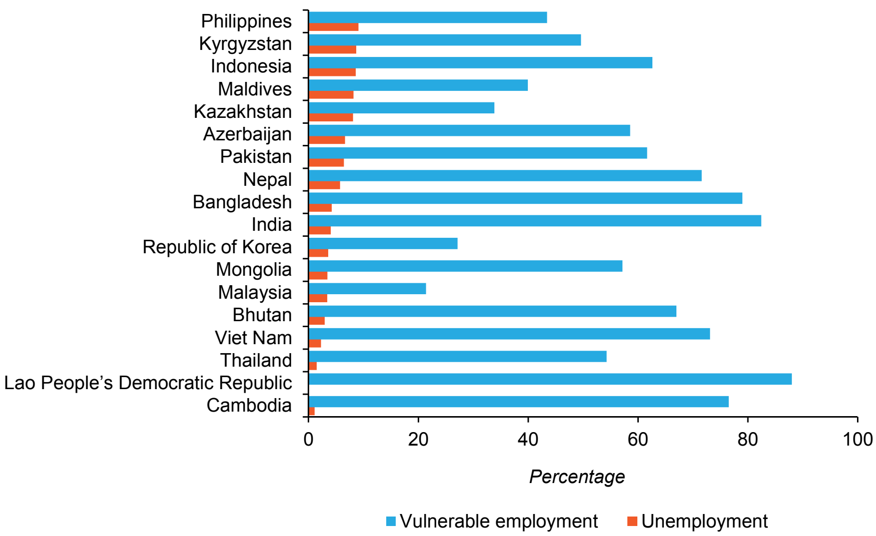
Official unemployment rates are calculated on the basis of the number of registered unemployed people. As there is little benefit in registering in most countries (due, for instance, to the lack of unemployment insurance), formal rates of unemployment are relatively low in the region, declining to less than 10% in all of the 18 countries shown in Figure 3.5. Yet, in contrast, vulnerable employment is quite high – in most countries exceeding half the number of the persons employed.

Vulnerable employment is particularly significant among women. For example, in East Asia, 52.7% of women that are employed are engaged in vulnerable employment, compared with 45.4% of men. In South-East Asia and the Pacific, the corresponding percentages are 65.9% and 58.5%, and in South Asia the figures are 83.8% and 75.5%, respectively. Moreover, women who choose or are compelled to combine work with childcare may find themselves in insecure jobs in the informal sector. It should also be mentioned that, in the Asia-Pacific region in 2012, 28.9% of females were engaged as contributing family workers compared with 9.2% of males (ESCAP, 2013a). Although some progress has been made, the gender wage gap persists, including in Australia, Cambodia, Mongolia, Myanmar and Sri Lanka. While the gap has narrowed over time, in 2011 it was particularly wide in Azerbaijan, Georgia and Pakistan. It is worth pointing out that the gender pay gap has narrowed in several economies, including Armenia; Azerbaijan; Georgia; Hong Kong, China; and Thailand, while it increased or remained the same in other economies where data are available.

One reason for the uneven progress that has taken place within economies is the fact that economic growth has not necessarily resulted in a commensurate rise in employment. Since the 1990s, the Asia-Pacific region has seen growth in both productivity and employment. Yet, the employment intensity of that growth, which is a numerical measure of how employment varies with economic output, was lower in the period 2008-2012 than in the 1990s in three subregions: East and North-East Asia; South and South-West Asia; and South-East Asia (table 3.4). This means that more jobs per unit of output were created in the 1990s than is currently the case. In contrast, in the Pacific subregion and in North and Central Asia, the number of jobs has increased since the 1990s.

The low employment elasticity of growth implies that economic growth is generating lower employment but more productive jobs, which is not necessarily unsatisfactory. However, in a region where large parts of the labour force are working in the informal, less

Figure 3.5. Unemployment and vulnerable employment in selected Asia-Pacific economies, most recent data



Source: ESCAP statistics.

Table 3.4. Average growth of output and employment, and employment intensity of growth in Asia-Pacific subregions

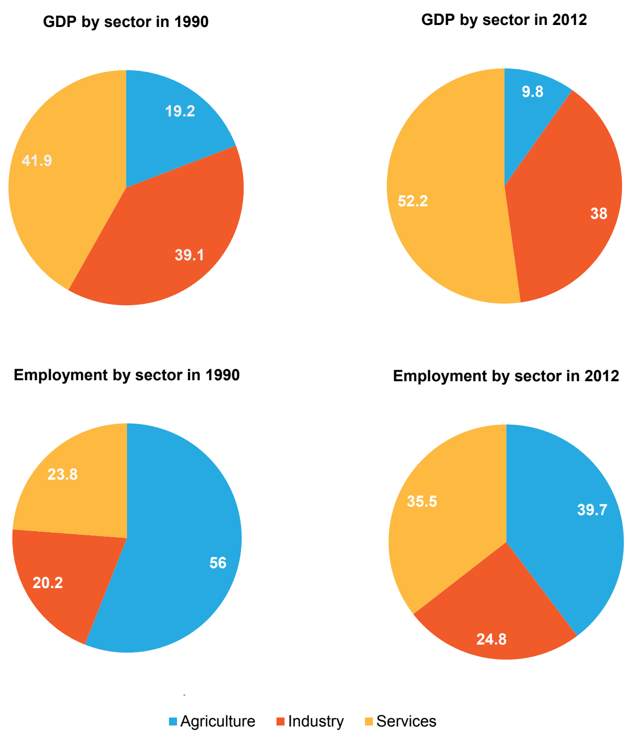
Subregions	GDP growth rate (percentage)			Total employment, change per annum (percentage)			Employment intensity of growth (percentage)		
	1990-1990	2000-2007	2008-2012	1990-1999	2000-2007	2008-2012	1990-1999	2000-2007	2008-2012
East and North-East Asia	3.2	4.4	3.8	1	1.1	0.5	0.31	0.25	0.13
North and Central Asia	-5.1	7.5	2.5	-0.4	1.7	0.7	0.08	0.23	0.28
Pacific	3.3	3.4	2.3	1.9	2.5	1.7	0.58	0.74	0.74
South and South-West Asia	4.8	6.3	4.9	2.3	2.2	1.4	0.48	0.35	0.29
South-East Asia	5.4	5.6	4.7	2.4	1.8	2	0.44	0.32	0.43

Source: ESCAP calculations.

productive sector, or where underemployment is a concern, more emphasis must be given to creating jobs.

The lower employment elasticity of growth may be the result of differences in relative performance of agriculture, industry and services that can be observed in many countries. In India, for instance, economic growth has been driven mostly by the expansion of the services sector, which grew by 9-10% per annum between 2002 and 2012, compared with agricultural growth of only about 3% per annum. Owing to differences in growth rates, the contribution of agriculture to GDP has thus declined in India from more than 50% in 1950 and about 30% in 1990 to 18.2% in 2013. Yet, agriculture still accounts for almost half of total employment in that country. Indeed, while the contribution of agriculture to GDP has almost halved in developing ESCAP countries since 1990 and currently contributes to only 10% of output, 4 out of 10 workers are still employed in this sector (figure 3.6).

Figure 3.6. Value added in GDP and percentage distribution of labour, by sector, developing ESCAP economies



Source: ESCAP statistics.

1.2. SOCIAL INCLUSIVENESS

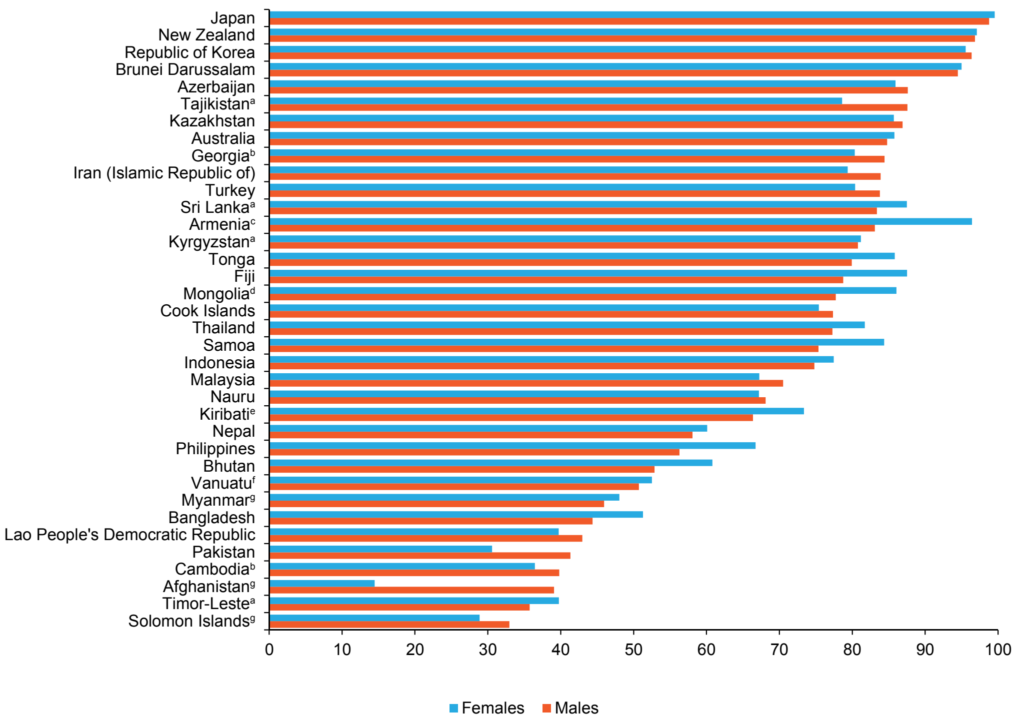
As had been pointed out in the *Survey* for 1979, which widened the discussion of inequality beyond income and wealth, inequalities emerge in many other components of development (ESCAP, 1980). Indeed, "inequality in income" must be distinguished from "inequality of opportunity", which refers to inequalities resulting from circumstances that are beyond an individual's control. Thus, outcomes, such as "earnings" or "income", can be determined by factors for which a person can be responsible, such as the amount of effort exerted in a job, as well as factors that are beyond a person's control and are often dependent on family circumstances. In this context, there are multiple forms of deprivation, many of which tend to overlap and reinforce each other, which can be expressed as inequalities.

Two critical factors that are usually beyond a person's control are the availability of education and health services. Indeed, access to health care and education are important objectives in their own right, to the extent that they are enshrined in the Universal Declaration of Human Rights. Health and education are therefore critical social factors in identifying whether growth has been inclusive. They are also critical in the actual process of growth itself as improving health and education outcomes serves to accelerate economic growth.

1.2.1. Education

The region as a whole has made significant progress in improving access to education. One success is that most countries in the region, with the exception of Afghanistan and Pakistan, have achieved universal primary education. However, the picture is different for secondary education and even more so for tertiary education. There are still several countries where more than half the children of secondary school age are not enrolled in school. In several countries, girls' secondary enrolment lags behind that of boys. However, some countries also face a new form of gender imbalance in education, where significantly more girls than boys receive education – in many cases because families put their boys to work. In several countries, net enrolment in secondary school among girls is relatively higher than among boys (figure 3.7).

Figure 3.7. Secondary school net enrolment of boys and girls, selected economies in the Asia-Pacific region, 2012



Source: UNESCO Institute for Statistics.

Notes: [a] 2011 data, [b] 2008 data, [c] 2009 data, [d] 2006 data, [e] 2005 data, [f] 2010 data, [g] 2007 data.

It also should be noted that disparities within countries occur not only along gender lines, but also particularly between rural and urban areas and according to income group. Available data show that in general higher-income groups receive more years of schooling than lower-income groups. Moreover, while in many countries girls in lower-income quintiles receive fewer years of education, in higher-income quintiles the gap between boys and girls is significantly smaller, if one exists at all. For example, in India in the lowest-income quintile, girls receive on average half as many years of education as boys. In Pakistan, the gap is even more glaring (table 3.5). Thus, in many countries, gaps in education between boys and girls are primarily an issue of income. This is especially so in many countries where there are differences in the quality of the education received, with the poor attending mainly poorly maintained, overcrowded public schools, whereas the children of wealthier parents can attend well-funded private schools, a situation which over time aggravates intergenerational inequality.

Data from household surveys also show that there are disparities in secondary school attendance between rural and urban areas and that gender gaps are often more pronounced in rural areas (figure 3.8). In some countries, such as India, Nepal and Viet Nam, more girls in urban areas than boys in rural areas attend school, making the rural-urban gap wider than the gender gap. In Bangladesh and Indonesia, girls' school attendance is higher than that of boys in rural areas. Specific policies that encourage girls' school attendance in rural areas may be the reason for this phenomenon (Khandker, Pitt and Fuwa, 2003).

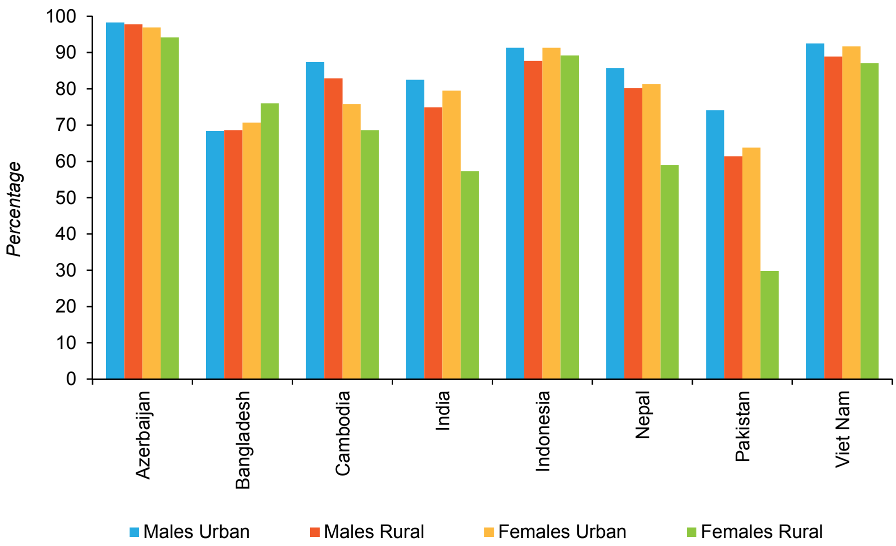
While much has been achieved in increasing school enrolment in the region, there are still large disparities in the quality of education that different population strata can access. Using educational achievement as an indicator, disparities are particularly great between different income groups (see box 3.3). For example, in India in 2005, 62% of those in the lowest-income quintile were found in the bottom 20% of the distribution of years of schooling attained for the age groups 17-22 years and 23-27 years, compared with only 3% of the highest-income quintile. Moreover, in India only 20% of assessed children in the lowest-income quintile completed primary school and achieved

Table 3.5. Average years of education for boys and girls, by income quintile, selected countries in the Asia-Pacific region

	Q1 (lowest)		Q2		Q3		Q4		Q5 (highest)	
	Girls	Boys	Girls	Boys	Girls	Boys	Girls	Boys	Girls	Boys
Armenia	8.3	8.1	8.8	9.2	9.3	9.0	9.5	9.6	9.6	10.1
Azerbaijan	9.4	10.1	10.1	10.3	10.4	11.0	10.9	11.1	11.4	11.4
Bangladesh	3.5	3.8	4.5	4.8	5.6	5.6	6.6	6.8	8.1	8.0
Cambodia	2.8	4.0	3.7	4.9	4.7	5.8	5.8	6.9	7.8	8.7
Georgia	10.6	10.2	11.2	11.0	11.3	11.4	12.0	11.7	12.7	12.4
India	3.0	5.7	5.0	7.2	7.3	8.4	9.2	9.5	11.2	11.1
Indonesia	6.7	6.6	7.9	7.8	9.0	9.0	10.0	10.0	11.0	11.3
Kazakhstan	11.6	11.2	12.1	11.4	12.4	11.9	12.8	12.5	13.4	13.1
Kyrgyzstan	10.5	10.4	10.6	10.4	10.6	10.4	10.7	10.4	11.0	10.8
Lao PDR	4.5	7.4	8.6	9.0	8.3	9.0	7.6	9.0	8.2	8.0
Myanmar	3.4	3.8	4.5	4.9	5.5	5.6	6.6	6.5	7.7	7.7
Nepal	2.4	5.0	3.3	5.6	4.3	6.4	5.9	7.4	8.2	9.3
Pakistan	1.1	3.8	2.3	5.0	4.4	6.2	6.4	7.3	8.8	9.1
Philippines	7.1	5.8	8.9	7.7	9.9	9.0	10.9	9.9	11.0	11.0
Tajikistan	8.6	9.8	8.6	10.1	9.2	10.1	9.2	10.3	10.3	11.3
Turkey	5.2	7.4	7.4	9.0	8.4	9.2	7.4	8.7	8.9	9.4
Viet Nam	5.2	5.3	7.8	7.8	8.5	8.8	9.5	9.2	10.2	10.7

Source: UNESCO, Deprivation and Marginalization in Education (DME) database. Available from www.unesco.org/fileadmin/MULTIMEDIA/HQ/ED/GMR/html/dme-1.html.

Figure 3.8. Gender and rural/urban gaps in secondary school attendance, selected countries



Source: United States Agency for International Development, Demographic and Health Surveys, DHS Program STATcompiler. Available from www.statcompiler.com.

an international minimum learning standard in reading, compared with 55% of children in the highest-income quintile. These statistics suggest that there are large differences in the quality of education received according to income quintiles. Similarly large wealth disparities also exist in Mongolia, where 55% of the poorest population group was found in the bottom educational quintile, but only 3% of the richest were found in that quintile. By contrast, wealth disparities in educational attainment are relatively low in North and Central Asia, including in Uzbekistan, where the richest people are more likely to be found in the lowest educational quintile than the poorest people. It is also necessary to take into consideration that secondary enrolment rates are very high in North and Central Asia.

Large regional disparities also exist within countries. In India, for instance, 38% of the population between 20 and 24 years of age in the state of Bihar were in the bottom quintile of educational distribution, whereas this was the case for only 2% in Kerala. In the Philippines, 45% of the population aged 17-27 years were in the bottom 20% of the distribution of years of schooling attained, compared with only 7% for those from the National Capital Region.

1.2.2. Health

Access to health services is a further critical element in identifying whether growth has been inclusive. Better health, for instance, contributes to growth in several ways. For one, it improves the motivation and productivity of workers. It also reduces absenteeism within the workforce and can therefore contribute to strengthening growth. Better health may result in a decline in the dropout rate among school children and thus reinforce the positive impact of education on growth and equity, especially intergenerational inequality. As is the case with education, improvement in the health status of the poor is likely to increase their income-earning potential and thus reduce the prevailing disparity in distribution. Access to well-funded, high-quality health services should be available to the entire population. This can be done through the introduction of a variety of health insurance schemes. For Governments, health concerns also extend to such areas as improved sanitation and the provision of safe drinking water.

Access to health services is defined by *accessibility*, which is largely related to geographic location; *affordability*, which entails whether people can afford those services that are available; and *acceptability*,

Box 3.3. Measuring inclusiveness in schooling

To achieve inclusive growth, Governments should strive to expand opportunities and make opportunities equitable for their people. This is particularly relevant for education, as having the opportunity to attend schools that are egalitarian and well-funded is critical for the future of any society due to the importance of having a skilled workforce and an informed citizenry. Thus, if children are deprived of opportunities to attend school, then the society will have no hope of building its human capital, which is a critical requirement for inclusive growth.

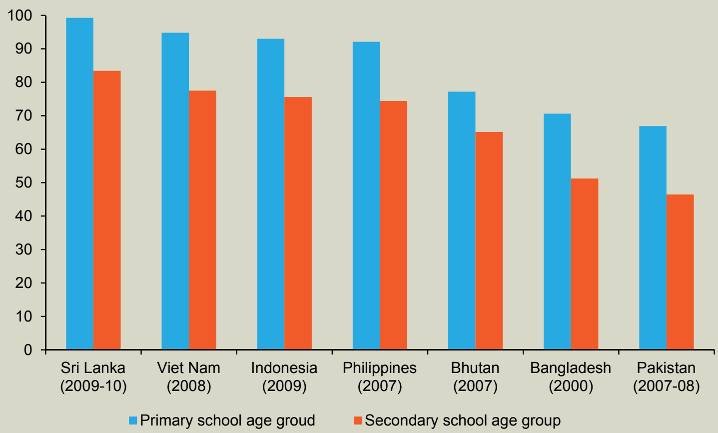
An opportunity index, which takes account of both the level of opportunities and the equity of opportunities across income quintiles in terms of enrolment in primary and secondary schooling (and hence ignores quality), is presented in figure A below for seven countries in Asia and the Pacific.[a] The data show that Sri Lanka offers the best opportunities for children in the primary and secondary school age groups (6-11 years and 12-17 years, respectively) followed by Viet Nam, Indonesia and the Philippines. Pakistan offers the fewest opportunities, followed by Bangladesh. In all seven countries, the percentage of children attending school increases monotonically from the bottom quintile to the top quintile between the two most recently available household surveys. This means that children coming from rich households have a better opportunity to attend school than those coming from poor households.

In Sri Lanka, almost all children in the primary school age group are attending school. The percentage of such children attending school was 99.39 % so there were hardly any children who did not attend school. The value of the equity index being 100 means that all children, regardless of their economic circumstances, have the opportunity to attend primary school. The situation in Sri Lanka is in stark contrast to the one in Bangladesh and Pakistan. In Pakistan, for instance, educational opportunities available to children are very few and largely determined by the economic circumstance of parents: only 57.4% of children from lowest-income quintile attended primary school in 2007/08 compared with 93.2% of those in the top quintile. Similarly, only 34.1% of children from the lowest-income quintile attended secondary school compared with 83.2% of those from the richest quintile.

In Indonesia, government policies have resulted in an improvement in the availability of opportunities for children of both primary and secondary school age. For instance, in 2005, Indonesia launched its Education for All National Plan of Action. Its strategies to achieve education for all, particularly in the secondary education sector, included the goal of reducing the cost of schooling as far as parents and communities were concerned, building more school facilities, improving quality assurance procedures (curriculum and examination systems) and developing a professional teaching force. In order to lighten education costs for poor students and to keep students in school, the Government committed to abolishing school fees, including tuition and monthly fees, at the primary and lower secondary levels.[b] Thus, 87% children aged 6-11 years attended school in 2000. In other words, an estimated 3.24 million children in the primary school age group had previously been deprived of the opportunity to attend school. By 2009, 94.3% of children were attending primary school, despite the relevant cohort being larger in size, suggesting that the opportunity for children of primary school expanded over the 9-year period. Nonetheless, 1.25 million children were still being deprived of the opportunity to receive primary schooling in 2009. With regard to secondary schooling, in 2002, 6.62 million children in the secondary school age group had been deprived of the opportunity to attend school; by 2009, this number decreased to 4.92 million children.

In contrast, opportunities for children of secondary school age in the Philippines declined significantly and became less equitable between 2002 and 2008, as the opportunity index decreased by more than 5% to 74.4. Thus, when looking at secondary schooling as an indicator, the pattern of growth in the Philippines cannot be said to be inclusive.

Figure A. Opportunity index for children in selected countries



Source: Based on Kakwani (2014).

[a] Kakwani (2014) developed an opportunity index, which is the product of the average opportunity available to the population and the equity of opportunity; the index informs how equitably opportunities are enjoyed by the population. The opportunities are said to be equitable (inequitable) if the equity index is greater (less) than 100. Since both equity indices are less than 100, it may be concluded that opportunities are inequitable.
[b] See UNESCO, *Secondary Education Regional Information Base: Country Profile – Indonesia* (Bangkok, 2010). Available from www.uis.unesco.org/Library/Documents/Indonesia.pdf.

which relates to the question of whether people are willing to use services when they are available and possibly affordable.

Accessibility of health-care services. While most countries in the Asia-Pacific region have made efforts to establish a system for the provision of public health, there are still spatial differences which in some cases have even intensified. For example, a large number of countries in the Asia-Pacific region cited the tendency to concentrate services in urban areas as a major reason for the lack of progress in the reduction of maternal mortality and infant mortality (United Nations, 2014c). A study conducted in several states of India found that 32% of respondents in rural areas did not have access to an outpatient care facility within 5 km of their homes, while only 17% in urban areas did not have access to such a facility. In rural areas, 63% of the respondents had to travel more than 5 km to access an inpatient facility, while in urban areas, only 27% had to travel more than 5 km to the closest inpatient facility (IMS Institute for Healthcare Informatics, 2013).

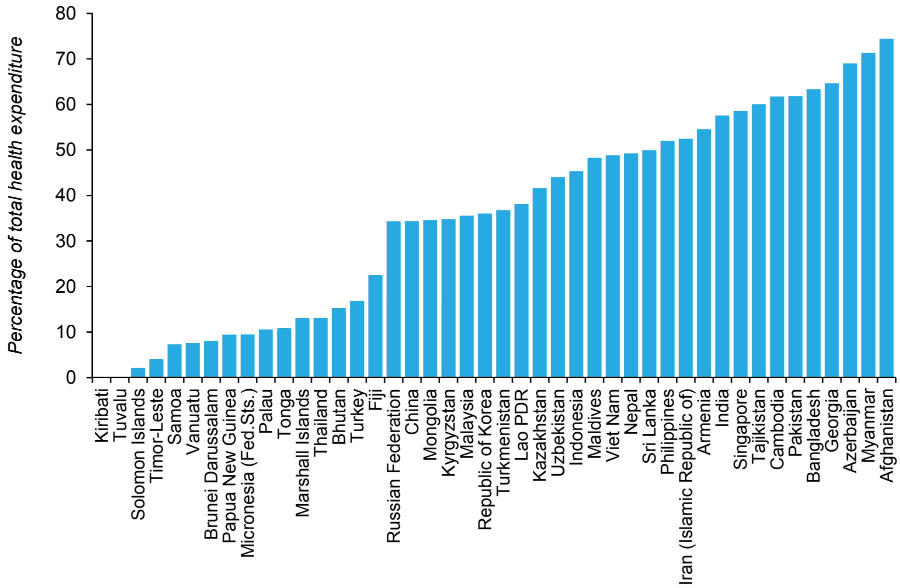
In addition, while Bangladesh, where 70% of the population reside in rural areas, has a relatively extensive public health infrastructure, only 44% of the major government facilities are rural-based (Rahman, Ashaduzzaman and Rahman, 2005). Moreover, many public health centres do not have qualified and experienced health professionals, with the result that the service that they can provide is often of poor quality. Rural-urban divides are even more pronounced in archipelagos or countries where the population lives in distant mountainous areas. For example, in Papua New Guinea the doctor-to-patient ratio is lower than 1 doctor per 10,000 people. Moreover, in 2010 less than 60% of health-care facilities in rural areas had a water supply in delivery rooms (WHO and Papua New Guinea, 2012). Similarly, in the highlands of Viet Nam, lack of transport facilities is often considered to be the key barrier to accessing health-care services (Bedford and others, 2013).

Affordability of health-care services. In many cases, people may not be able to afford health-care services even when they are available. In some instances, people may be able to access health-care services but only after they have made detrimental reductions in other household expenditures to afford so-called catastrophic payments. Indeed, in several countries, most health-care expenditure has to be borne by private households. This is reflected in the percentage of out-of-pocket payments compared with the total expenditure on health. If health-care costs have to be borne largely by the households themselves, then such expenditures are barely affordable to many of the households. Out-of-pocket payments in the Asia-Pacific region range from almost none in Kiribati and Tuvalu to almost 80% in Afghanistan and a number of other countries. In 13 countries in the region, almost 50% of all health expenditures emanate from private households, a situation that constitutes a major barrier for people to access health-care services (figure 3.9).

Surveys have shown that, particularly in lower-income quintiles, the cost of services is cited as the main barrier to using health-care services. For example, the Lao People's Democratic Republic introduced user fees for health-care services in 1995. To date, a relatively large proportion of health-care expenditures stems from out-of-pocket payments. Thus, financial barriers are considered as a key constraint for using health-care services, particularly among the poorest households. In rural areas, households in the highest-income quintile are three times more likely to seek hospital care than households in the lowest-income quintiles (WHO and Lao People's Democratic Republic, 2012).

However, there are also several countries in the Asia-Pacific region, among them several least developed countries, where private households bear only a small proportion of health expenditure. For example, Kiribati provides a system of free public health-care services for all its citizens, which is largely a tax-funded benefit although it is also funded by official development assistance. In that country, access to health-care services is determined largely by geography – there is less access in the outer islands – as well as by other factors, such as the limited decision-making power of women. Several other countries have achieved almost universal health-care services, whether through public service provision or through universal public health insurance, such as in Thailand. Other countries keep out-of-pocket payments low through the involvement of civil society actors in the provision of social services, such as faith-based organizations in Papua New Guinea (WHO and Papua New Guinea, 2012).

Figure 3.9. Out-of-pocket expenditure as a percentage of total health expenditure, selected economies in the Asia-Pacific region, 2012



Source: World Bank, World Development Indicators. Available from http://data.worldbank.org/data-catalog/world-development-indicators.

Acceptability of health-care services. There are also instances where people refrain from using health-care services even though they are available and affordable. In some cases, this may be due to the perceived lack of good-quality care, such that those who can afford to do so visit health facilities in other countries. In other cases, the services may not be considered as socially or culturally appropriate, which is particularly the case when it comes to sexual and reproductive health services. Studies have shown that, among patriarchal-oriented societies, husbands or in-laws often decide whether women in the household should make use of health-care services (Bedford and others, 2013). For example, studies on Bangladesh contain reports of numerous examples when women were denied pre- and antenatal health-care services because male family members considered the use of such services to be inappropriate. However, studies have also shown that the use of sexual and reproductive health services as well as health-care services for children increases with the educational level of both women and husbands, and it increases for younger women. Thus, cultural norms preventing women from using health-care services are more prevalent among the older generation and groups with lower education.

Studies on Viet Nam have also found that minority ethnic groups tend to use health-care services to a lower extent than majority ethnic groups. For example, indigenous communities in that country often do not make use of health services, even if their household is in close proximity to a health-care facility (Bedford and others, 2013). Yet, across income quintiles, public health facilities are relatively equitably utilized (box 3.4).

As a result of focusing on such factors as accessibility, affordability and acceptability, it can be found that the use of skilled birth attendants in many countries tends to be significantly lower in rural than in urban areas and also tends to be lower among lower-income groups than among higher-income groups. It also has to be considered that lower-income groups are also characterized by lower educational levels. Thus, in some cases, income is not the major determinant; education is.

Box 3.4. Measuring inclusiveness in access to health care in Indonesia, the Philippines and Viet Nam

The experiences of Asia and the Pacific in terms of access to health care and treatment received are quite varied. For instance, the health-care system in Indonesia is inequitable and favours the rich more than the poor. For instance, while only 18.7% of babies were delivered by qualified doctors in 2014, among the poorest 20% of the population, only 7.8% of babies were delivered by doctors compared with more than 40% for the richest 20% of the population. An equity index of only 0.76 shows that a large proportion of poor women are deprived of this very basic health service which is critical for the health of both mothers and babies.[a]

In terms of access to health-care facilities, the equity index for private hospitals is only 0.54, which implies that the poor do not have much opportunity to utilize private hospitals which tend to provide much higher-quality health care compared with public hospitals. Moreover, it is striking to note that the equity index for government hospitals is only 0.78, which is much less than 1, meaning that even when utilizing government hospitals the poor enjoy less opportunity than the non-poor. Since public hospitals are funded largely by the Government, it is critical to ensure that poor people can more readily access them. Currently, the richer population is utilizing more of services in both private and public hospitals.

Another basic health service is the vaccination of babies and young children, which is critical as children who have been deprived of appropriate doses of vaccination can be at risk of contracting various diseases and suffering serious health issues or even dying. Moreover, the provision of vaccination for all children is the cheapest kind of intervention that the Government can provide. Overall, using polio as an example of a highly dangerous disease, 9.3% of children had no protection in Indonesia in 2014. Yet, the equity index of 0.99 indicates that the children from both poor and non-poor households have more or less equal probability of getting a polio vaccination. Thus, family circumstances do not play a key role in protecting the children from serious diseases.

The Philippines is also characterized by serious inequity in accessing even very basic health services. For instance, in 2007 the equity index measure for seeking treatment from medical professionals was only 0.84, implying that there is a large degree of inequity in getting treatment from professional medical personnel. Yet, the equity index of 0.91 in the utilization of government hospitals suggests that the inequity is relatively smaller than that observed for Indonesia in 2014. Overall, the utilization rate was about 26.7% among the poorest 20% of the population, which increased to almost 35.8% among those belonging to the third quintile. The utilization rate among the richest 20% of the population was the lowest at about 23.2%.

In contrast, public health facilities are relatively equitably utilized in Viet Nam, such that family circumstances do not play a key role in the overall provision of access to health services. Thus, government facilities have an equity index equal to or greater than 1, with the exception of provincial hospitals and other State-owned hospitals, which are however not equitable because they are utilized largely by the urban population. Furthermore, private hospitals are located largely in urban areas and are utilized mainly by the richer population.

Source: Based on Kakwani (2014).

[a] Kakwani (2014) developed an opportunity index which is the product of average opportunity available to the population and equity of opportunity, which informs how equitably opportunities are enjoyed by the population. The opportunities are considered to be equitable (inequitable) if the equity index is more (less) than 100.

In some countries in the Asia-Pacific region, there are almost no differences in the presence of skilled birth attendants by income group or by rural and urban area, in spite of relatively high out-of-pocket expenditures involved with this service. This means that services are available, and there is a high awareness of the need for skilled birth attendants. This is the case in North and Central Asian economies, such as in Armenia and Kazakhstan, where initially the level of human development and the quality of human capital was much higher than in other developing countries with similar levels of income. Indeed, in the early 1990s several of these countries, including Uzbekistan, had developed a system of social institutions at a level comparable with rich countries which offered free health care, primary, general secondary, secondary-special and higher education (Djamalov and Eshonov, 2014).

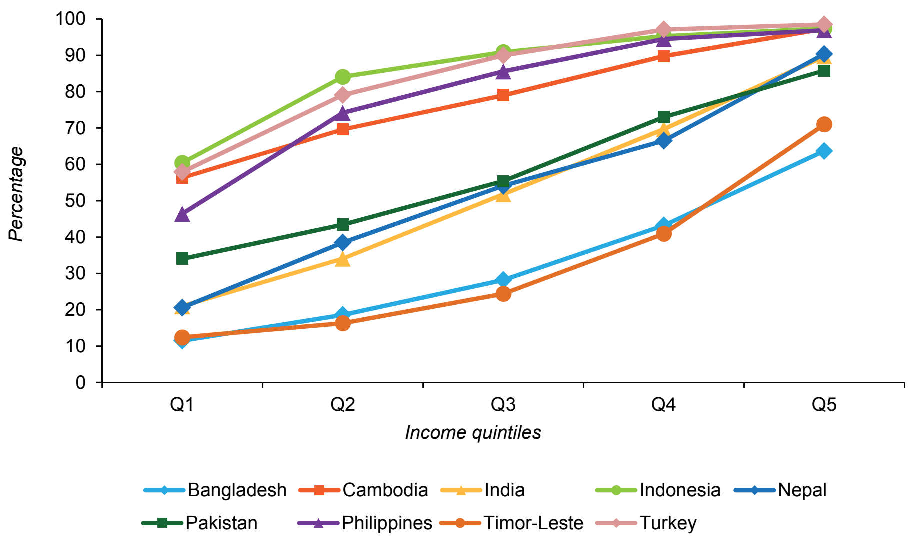
In other countries, the use of skilled birth attendants increases with income, but not proportionally, which shows that other factors in addition to affordability also play a role. For example, in Bangladesh in 2011, skilled birth attendants (doctors and other health-care staff) were present for 20.8% of births, yet there was a large degree of diversity among income groups, with the percentage of skilled birth attendants ranging between 11.5% for the lowest-income quintile to 63.7% for the highest-income quintile. The difference between the fourth and fifth income quintile was particularly high. In contrast, in Turkey, the use of skilled birth attendants increases most strongly between the lowest and the second lowest-income quintile, while close to 100% of births in the highest-income quintile are attended by skilled personnel (figure 3.10). The utilization of maternal health services, including skilled birth attendants, varies between countries due to differences in total health spending and proportion of government spending on health (Kruk and others, 2007). Moreover, utilization of skilled birth attendants across income quintiles has been found to be more equitable when higher health expenditures are accompanied by redistributive education policies (Kruk, Prescott and Galea, 2008).

1.3. INCLUSIVE DEVELOPMENT AND THE ENVIRONMENT

There is general agreement that economic growth, as measured by per capita national income, negatively affects environmental quality (Costantini and Martini, 2010). While degradation of the environment has adverse impacts on everyone, the poor are particularly affected as they are less resilient to the negative impacts of environmental degradation. At the same time, it is important to point to the two-way relationship between the environment and inequality and poverty. In particular, inequality and poverty also contribute to environmental degradation. This is because in less developed countries and for the poor in general, the focus is less pronounced with regard to the complex issues of the environment and how the environment affects their economic future. Rather, increasing one's income and securing one's survival are often more relevant. Environmental degradation can therefore also be an outcome of economic inequality.

When moving up the development ladder and tackling poverty and inequality, efforts must be made to safeguard the environment and to increase the access of people to basic infrastructure, such as electricity, clean drinking water and sanitation. Indeed, access to these forms of basic infrastructure can contribute to the improvement of health conditions and to a reduction in hazardous deaths. As such, it is important to consider the inclusiveness of growth while taking environmental factors into account.

Figure 3.10. Percentage of skilled birth attendance in three years preceding the survey, by income quintile, in selected countries in Asia and the Pacific. Most recent household data available.



Source: United States Agency for International Development, Demographic and Health Surveys, DHS Program STATcompiler. Available from www.statcompiler.com.

1.3.1. Access to improved sanitation and water facilities

Asia-Pacific countries made important progress in increasing access to improved water sources from 1990 to 2011. In fact, in the whole region, the percentage of people without access to improved water sources dropped from about 27% to about 8% during the above-mentioned period. The percentage of the population with access to improved water sources ranges between 88% in the Pacific and 93% in North and Central Asia (figure 3.11). Despite this progress, disparities still exist between rural and urban areas. For instance, in Afghanistan, Cambodia, Mongolia, Timor-Leste and Turkmenistan, the percentage of the population having access to improved water facilities is about 50% higher in urban areas than in rural areas.

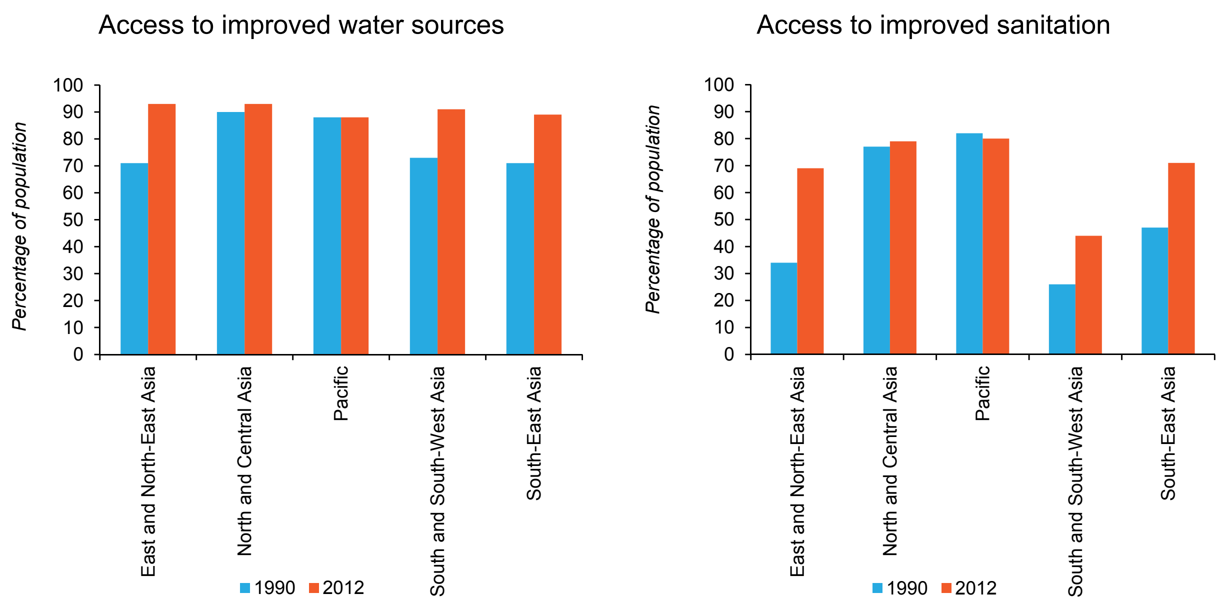
Compared with the accomplishments recorded in increasing people's access to improved water sources, achievements in their access to improved sanitation have been relatively moderate, with only about 59% of the Asian-Pacific population having access to such facilities in 2012 compared with about 36% in 1990. The South and South-West Asian subregion is conspicuous for having the lowest level of access to improved sanitation owing to the very low rates recorded in Afghanistan, Bhutan, India, Nepal and Pakistan. As a result, 798 million people lack access to these facilities in South and South-West Asia. In Nepal and Pakistan, this situation may be linked to increasing pressures from urbanization as the number of people living in slums in urban areas has increased significantly (figure 3.12).

Moreover, access to improved sanitation is also characterized by important disparities between rural and urban areas. The percentage of people having access to improved sanitation in urban areas of Bhutan, Cambodia, India, Pakistan and Timor-Leste was equal to more than twice that recorded in rural areas in 2012.

1.3.2. Access to energy and growth in total greenhouse gas emissions

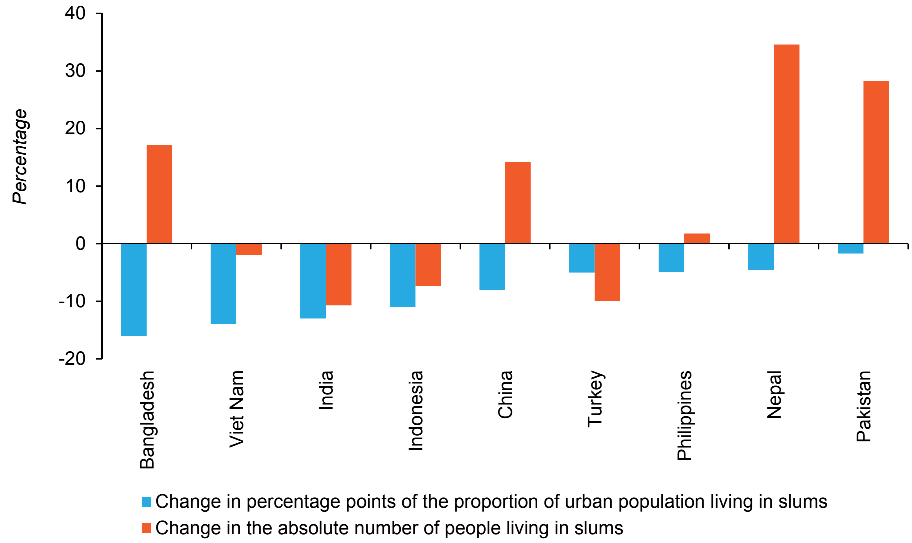
Greenhouse gas (GHG) emissions increased considerably in the Asia-Pacific region between 1990 and 2010 on the back of the significant economic expansion recorded in many economies in the region. Such emissions jumped by an average growth rate of 4.1% between 2000 and 2010, over

Figure 3.11. Access to improved water sources and sanitation, 1990 and 2012



Source: ESCAP, *Statistical Yearbook for Asia and the Pacific 2014* (ST/ESCAP/2704, Bangkok).

Figure 3.12. Comparison between the change in percentage points and growth rate of the urban population living in slums in selected countries, between 2000 and 2010

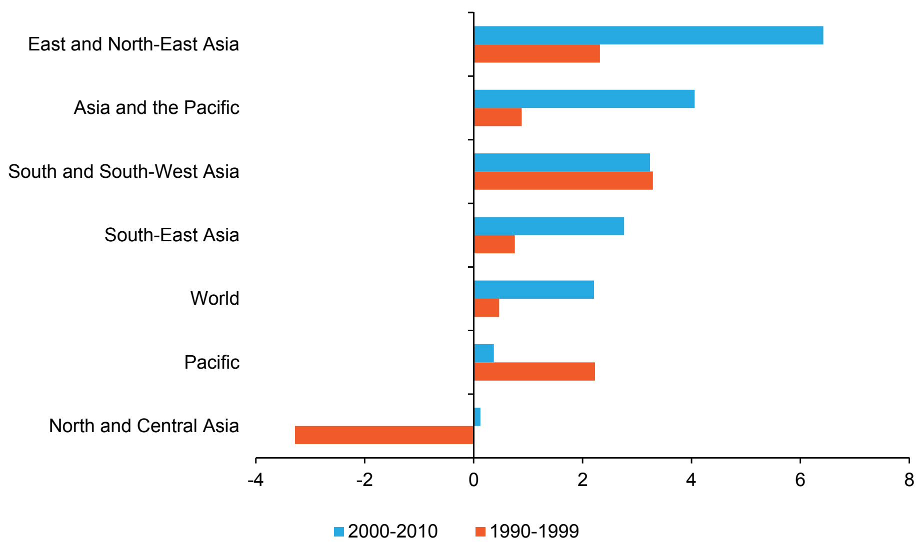


Source: ESCAP, based on data from the United Nations Human Settlements Programme, Department of Economic and Social Affairs, *World Urbanization Prospects: The 2014 Revision* (ST/ESA/SER.A/352); and United Nations, *The Millennium Development Goals Report 2013* (Sales No. E.13.I.9).

the average growth rate of 0.9% during the 1990s (figure 3.13). The contribution of the Asia-Pacific region to total global GHG emissions was more than 50% from 1990 to 2010, with most emissions originating in East and North-East Asia; China accounts for more than 80% of the emissions.

The increase in GHG emissions, comprising a sizeable quantity of carbon dioxide (CO2), was driven mainly by the combustion of fossil fuels for electricity generation, transport and industrial uses. Even if the CO2 intensity (measured in metric tons of CO2 emissions per $1,000 of GDP) during

Figure 3.13. Percentage of change per annum in total greenhouse gas emissions, by subregion, 1990-2010



Source: ESCAP, *Statistical Yearbook for Asia and the Pacific 2014* (ST/ESCAP/2704, Bangkok).

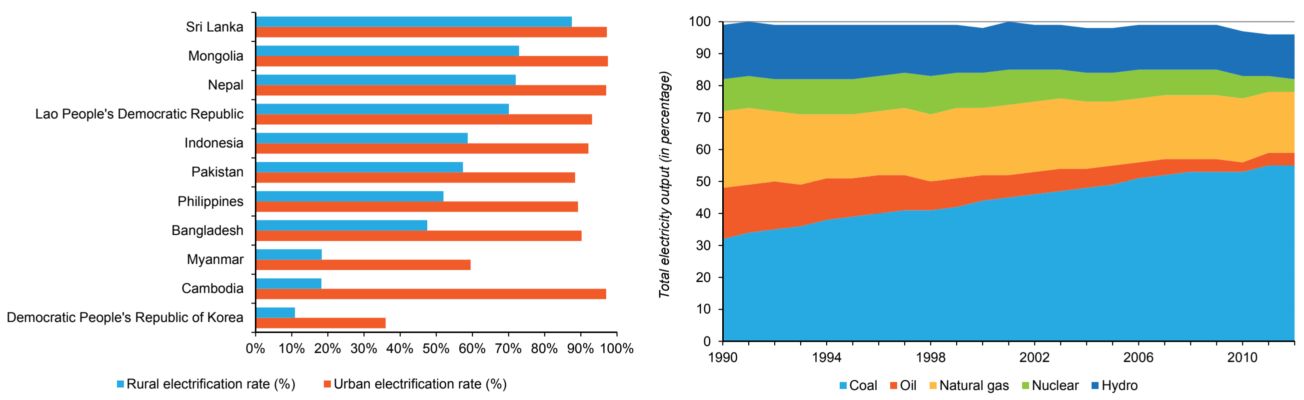
the reference period had been decreasing, it still remains quite high and was approximately 50% higher than the global average intensity in 2010. This reflects the significant use of fossil-fuel-intensive technologies in the region. In such countries as Cambodia, the Lao People's Democratic Republic and Mongolia, the CO2 intensity was into two-digit levels in 2010, while the intensity was equal to 1.2 in the Asia-Pacific region and 0.8 at the global level.

In responding to the increasing demand for energy, the production of electricity has increased significantly since 1990. Compared with urban populations, however, rural populations in many countries still do not have access to basic energy services (figure 3.14). Thus, at least 620 million people lack access to electricity in the region and almost 1.9 billion people still rely on biomass for cooking (International Energy Agency, 2014). The use of biomass is a significant health concern due to the amount of air pollution it produces when burned indoors; more than 1 million premature deaths annually in India and China can be attributed to exposure to household air pollution (WHO, 2014).

In terms of sources of energy, renewable ones, such as biofuels, are becoming increasingly important but fossil fuels, particularly coal, remain major energy sources used in production processes. Biofuels are produced mainly by China, India, Malaysia, the Philippines and Thailand; the coal production of China and India accounts for more than half of the global output (UNESCO, 2014). However, the use of both categories of products also poses issues of water stress because their production processes are water-intensive, and the production of biofuels increases the demand for arable land – thus leading to deforestation.

Only marginal efforts have been made to conserve forest areas in the region; as a result, the percentage of conserved forest areas has barely increased, inching up from 30.5% in 2005 to 30.6% in 2012. The scant growth is attributable mostly to the achievements recorded in China and India where more trees have been planted than in other areas. In fact, by excluding China and India from the regional analysis, a regression would have been recorded, with East and North-East Asia and South-East Asia (excluding the Philippines, Singapore and Viet Nam) being the subregions most adversely affected by deforestation. These developments affect the poorest populations as they rely heavily on forests to ensure their access to food, medicine and several other non-wood products needed to sustain life.

Figure 3.14. Access to electricity in selected Asian economies, 2012, and sources of electricity production in the region, 1990-2012



Source: ESCAP, based on data from the International Energy Agency, *World Energy Outlook 2014* (Paris, OECD/IEA, 2014); and ESCAP, *Statistical Yearbook for Asia and the Pacific 2014* (ST/ESCAP/2704, Bangkok).

2. ESCAP INDEX OF INCLUSIVENESS

The foregoing discussion shows that any judgement call on whether growth has been inclusive in Asia and the Pacific becomes clouded once the multidimensional character of *inclusiveness* is considered. For example, while a country may have made significant advances in terms of social development, its success in accelerating poverty reduction or reducing income inequality may be less obvious. Indeed, even within each category of the three dimensions of sustainable development, that is, economic, social and environmental development, it may not be clear whether growth has been inclusive. How would one judge, for instance, the case of the region's two most populous countries, India and China? In terms of economic inclusiveness, the rate of extreme poverty has declined in these countries by 34% and 80% respectively since 1990, yet this has happened at the cost of a large increase in income inequality, with the Gini coefficient increasing by 10% and 30% respectively.

To address this issue in a more methodological manner, this section presents a composite index for each of the three dimensions of sustainable development, comprising the indicators presented above, as well as a composite index of the three indices to gauge how growth has impacts on overall inclusiveness.

There is, of course, some controversy in creating composite indicators by adding up indicators from different fields to arrive at a total score, as reducing any multidimensional phenomenon to a simple numerical value raises technical and political issues (Atkinson and Marlier, 2010). Doing so has, for instance, raised concerns and issues regarding the substitutability between components of composite indicators to achieve higher scores (Ravillion, 2012). Keeping these caveats in mind, the creation of an aggregate performance measure is nevertheless useful when presenting an overall picture and when drawing comparisons between countries and over time. Indeed, several composite indicators that arguably capture "inclusiveness" have already been created. These include, for example, the World Bank's Country Policy and Institutional Assessment for policies to bring about social inclusion and equity, and the Human Development Index of UNDP. The Asian Development Bank has created the Framework of Inclusive Growth Indicators (box 3.5), although it is not a composite indicator. It should also be mentioned that the scoring methods of these indicators are not always clear, and for some indices the choice of weights is discretionary. Moreover, in some cases input variables that represent policies are mixed with output variables of inclusiveness.

2.1. The economic dimension of inclusive growth

The discussion on indicators of economic inclusiveness presented in the previous section demonstrated that country experiences, when considering different dimensions of economic inclusiveness, vary considerably. Whereas almost all countries have made significant progress in reducing rates of poverty, the levels of inequality have increased in many countries, and access to decent and productive employment, including for females, remains precarious. Creating a composite index that captures the above-mentioned elements would enable a simple comparison across countries and time. The following indicators are therefore combined into a composite indicator that gives equal weight to each of the 5 components: (a) the poverty headcount ratio at $1.25 per day in 2005 PPP (percentage of population); (b) the Gini coefficient; (c) the ratio of income shares held by the highest quintile to the share held by the lowest quintile; (d) the unemployment rate (percentage), and (e) the ratio of the female-to-male labour-force participation rate (percentage). Data availability enabled scoring for 22 countries across the periods 1990-1999 and 2000-2012 (table 3.6).

Data show that scores for economic inclusiveness increased since the 1990s in all countries except Georgia and Turkey. In Georgia, all five components of the index deteriorated, while in Turkey the decrease was driven by a decline in employment and the relative female labour-force participation rate, as well as an increase in the share of income held by the highest quintile relative to that of the lowest quintile. The largest increase in scores occurred in Armenia, Azerbaijan and Maldives.

Overall, however, it must be noted that economic inclusiveness is primarily driven by the region's overwhelming success in reducing rates of extreme poverty. In fact, the increase in this (normalized) indicator is sufficiently large to offset the worsening in income inequality and in employment that has to a large degree characterized the region, especially in the three most populous countries, China, India and Indonesia.

Box 3.5. Existing indices and inclusiveness

To help guide the allocation of International Development Association lending resources, the World Bank has since 1998 included governance and social policy indicators as part of its Country Policy and Institutional Assessment (CPIA). This mechanism is used to assess the quality of a country's current policy and institutional framework. A total of 16 CPIA criteria are grouped into four clusters, one of which, the CPIA for Policies for Social Inclusion and Equity, is particularly relevant for measuring just how inclusive economic growth has been in a country.[a] This cluster represents the average score of five criteria: (a) gender equality; (b) equity of public resource use; (c) the building of human resources; (d) social protection and labour; and (e) policies and institutions for environmental sustainability. Data on this cluster, spanning the period 2004-2013, are available for 28 countries in the Asia-Pacific region.

Overall, the scoring of countries in the region ranks between 2.6 and 4.1, where countries are rated on a scale from 1 (low) to 6 (high). A rating of 1 corresponds to a very weak performance; a rating of 6, to a very strong performance. Since 2005, there have been improvements in most countries in terms of their scoring for policies for social inclusion and equity, suggesting that development has become more inclusive in those countries. Azerbaijan and Nepal have improved their scores by one full point in the human resources rating. Nepal has improved its gender equality rating score by 1 and Mongolia has improved its score by 1 for the rating on policy and institutions for environmental sustainability. Yet, scores in eight countries in the region have remained unchanged, and in five countries scores have actually deteriorated.

The human development index (HDI) of UNDP is a widely used indicator to gauge how countries are faring in terms of their development. This index was created to emphasize that people and their capabilities should be the ultimate criteria for assessing the development of a country, not economic growth and income alone. Thus, HDI represents the score of a composite statistic of life expectancy, education and income indices used to rank countries into four tiers of human development.

Similarly, the UNDP gender inequality index (GII) affords an overview that uses a "gender lens" to measure the inequality of access to labour markets and high-level positions. The multidimensional poverty index (MPI) provides information on deprivation in non-income dimensions, such as education, health and living standards. However, some shortcomings in the use of these indicators are that HDI and MPI are not integrated in one dimension, that is, MPI is based on household surveys and GII has been developed only recently.

Overall, regarding HDI, almost all the 45 economies in Asia and the Pacific with available data have seen improvements in their human development score since the 1990s. In several countries, the increase has been significant, exceeding 40% in, for instance, Afghanistan, Bangladesh, Cambodia, China, the Lao People's Democratic Republic and Myanmar.[b]

The divergence of human development scores is quite significant in the region. In 2013, Singapore had the highest score in the region and ranked in the ninth position (out of 187 countries); Afghanistan ranked the lowest in the region, at a global rank of 169. Indeed, in 2013, the human development score for Afghanistan, Papua New Guinea and Solomon Islands was below that achieved by China in 1990.

Among other studies, the Asian Development Bank has developed an integrated framework of inclusive growth indicators where poverty and inequality outcomes of inclusive growth are measured by three income-related indicators and three non-income-related indicators for assessing progress on income poverty as well as non-income poverty. On the basis of this framework, McKinley (2010) derived a composite index for six countries in the region. However, the scoring method of this index is not clear and the choice of weights for each component is discretionary. Moreover, the framework presents some weaknesses as input variables that represent economic policies are mixed with output variables of inclusiveness. Sugden (2012) assessed the growth experience of 22 developing economies in the region, paying special attention to 11 economies, using a distribution-weighted measure that was used to analyse individual indicators. Anand, Mishra and Peiris (2013) estimated a unified measure of inclusive growth for emerging markets. Yet, they did so by integrating countries' economic growth performance and income distribution outcomes using data over three decades, thereby ignoring the multidimensional aspect of inclusiveness.

[a] The three other clusters relate to: (a) economic management; (b) structural policies; and (c) public sector management and institutions. See World Bank (2011).
[b] The only country which has experienced a marginal decline in its human development score is Tajikistan, where HDI contracted by 0.5% between 2013 and 1990.

Table 3.6. Score and rank of economic inclusiveness, selected countries in Asia and the Pacific

Country	Score		Rank	
	1990-1999	2000-2012	1990-1999	2000-2012
Armenia	0.60	0.68	21	18
Azerbaijan	0.73	0.83	8	2
Bangladesh	0.69	0.70	15	15
Cambodia	0.76	0.79	4	6
China	0.74	0.75	6	10
Georgia	0.73	0.70	9	16
India	0.67	0.68	17	17
Indonesia	0.70	0.72	12	13
Iran (Islamic Republic of)	0.61	0.65	20	22
Kazakhstan	0.79	0.83	2	1
Lao People's Democratic Republic	0.78	0.80	3	4
Malaysia	0.69	0.74	14	12
Maldives	0.49	0.76	22	8
Nepal	0.71	0.75	10	11
Pakistan	0.61	0.67	19	21
Philippines	0.66	0.68	18	19
Russian Federation	0.74	0.79	5	7
Sri Lanka	0.70	0.71	13	14
Tajikistan	0.71	0.75	11	9
Thailand	0.79	0.81	1	3
Turkey	0.69	0.67	16	20
Viet Nam	0.74	0.80	7	5

Sources: ESCAP calculations.

Note: The index scores (columns 2 and 3) range between 0 and 1, with a higher score referring to more inclusiveness.

2.2. The social dimension of inclusive growth

Performance within and between countries in the region is mixed in terms of social opportunities that are available. To capture social inclusiveness, the following indicators were used: (a) gender parity at the secondary school level; (b) gross secondary school enrolment; (c) average years of schooling; (d) percentage of live births attended by skilled health staff; and (e) the mortality rate of children under age 5 (per 1,000 live births). Measuring the quality of education is important, though technically difficult due to the absence of indicators. Completion rates are one indicator of the quality of education, yet available data for the region are scant. However, as improvements in completion rates contribute to rising average years of schooling as younger cohorts mature over time, it can be argued that capturing the latter implicitly captures the former. A decrease in the mortality rate of children under age 5 is one of the outcomes of a good health system. Overall, data availability enables ranking the social inclusiveness index for 23 countries across the periods 1990-1999 and 2000-2012 (table 3.7).

The scores reveal that in all countries there were improvements in terms of social inclusiveness, as captured by the composite indicator. In several countries, the improvement was quite significant, particularly in those ranked lowest in the 1990s. Thus, although their relative ranking did not change, scores increased by more than 40% in Bangladesh and Cambodia and by more than 60% in Nepal and Pakistan.

Table 3.7. Score and rank of social opportunities, selected countries in Asia and the Pacific

Country	Score		Rank	
	1990-1999	2000-2012	1990-1999	2000-2012
Bangladesh	0.35	0.50	20	20
Brunei Darussalam	0.83	0.89	4	5
Cambodia	0.34	0.49	21	21
China	0.65	0.81	13	9
Fiji	0.81	0.86	6	6
India	0.40	0.54	18	18
Indonesia	0.51	0.73	16	15
Iran (Islamic Republic of)	0.66	0.81	12	11
Kazakhstan	0.83	0.90	3	4
Malaysia	0.76	0.84	7	7
Maldives	0.64	0.72	14	16
Mongolia	0.67	0.81	11	8
Myanmar	0.46	0.58	17	17
Nepal	0.29	0.47	22	22
Pakistan	0.25	0.42	23	23
Papua New Guinea	0.39	0.50	19	19
Philippines	0.68	0.74	10	14
Russian Federation	0.88	0.93	1	1
Sri Lanka	0.81	0.92	5	2
Tajikistan	0.72	0.75	8	13
Thailand	0.71	0.81	9	10
Tonga	0.86	0.91	2	3
Turkey	0.59	0.77	15	12

Sources: ESCAP calculations.

Note: The index scores (columns 2 and 3) range between 0 and 1, with a higher score referring to more inclusiveness.

2.3. The environmental dimension of inclusive growth

In this component, the indicators track changes that have occurred in the air and in forest areas and in the consumption of fossil fuels, as these aspects may relate to important damaging impacts on the environment. The indicators also measure the deprivation of people in terms of their access to basic facilities, such as improved drinking water sources and sanitation facilities. Thus, the following five indicators are used: (a) the percentage of the population with access to improved sanitation facilities; (b) the percentage of the population with access to improved water sources; (c) annual increase in total GHG emissions; (d) annual percentage change in forest area; and (e) annual percentage change in the share of fossil-fuel energy consumption in the total consumption of energy. It is assumed that high increases in GHG and fossil-fuel energy consumption and deforestation contribute to unsustainable development.

Overall, scores for 25 countries were computed (table 3.8). They reveal that five of the six countries that saw a decline in their scores since the 1990s are located in North and Central Asia. In those economies, the increase in GHG emissions was the primary driver of the worsening of their score. In Cambodia, the one country out of the six not located in that subregion, this increase more than offset gains in the score due to improved access to sanitation facilities and improved water sources, whereas in Armenia, Georgia and Tajikistan a

Table 3.8. Score and rank of environmental opportunities, selected countries in Asia and the Pacific

Country	Score		Rank	
	1990-1999	2000-2012	1990-1999	2000-2012
Armenia	0.75	0.69	4	13
Azerbaijan	0.63	0.66	15	17
Bangladesh	0.59	0.62	17	19
Cambodia	0.43	0.40	25	25
China	0.57	0.63	18	18
Democratic People's Republic of Korea	0.67	0.68	13	14
Georgia	0.81	0.73	1	7
India	0.53	0.58	23	21
Indonesia	0.54	0.59	20	20
Iran (Islamic Republic of)	0.70	0.74	9	4
Kazakhstan	0.78	0.74	2	6
Malaysia	0.71	0.75	8	2
Mongolia	0.53	0.58	21	22
Myanmar	0.56	0.67	19	16
Nepal	0.45	0.57	24	23
Pakistan	0.53	0.57	22	24
Philippines	0.64	0.69	14	12
Republic of Korea	0.74	0.76	5	1
Russian Federation	0.69	0.69	11	10
Sri Lanka	0.61	0.69	16	11
Tajikistan	0.73	0.67	6	15
Thailand	0.70	0.74	10	5
Turkey	0.68	0.72	12	8
Turkmenistan	0.75	0.71	3	9
Viet Nam	0.72	0.75	7	3

Sources: ESCAP calculations.

Note: The index scores (columns 2 and 3) range between 0 and 1, with a higher score referring to more inclusiveness.

significant increase in the share of fossil-fuel energy consumption in the total consumption of energy contributed further to declines in environmental sustainability. In contrast, the three economies with the most significant improvement in their environmental sustainability scores, Myanmar, Nepal and Sri Lanka, each experienced a significant decline in the percentage of change per annum in the share of fossil-fuel energy consumption in the total consumption of energy and important improvements in access to sanitation facilities and improved water sources. Yet, as Myanmar and Nepal had very low scores in the 1990s, despite their improvement, they did not move up in the relative ranking of countries.

2.4. Inclusive growth

As detailed above, inclusiveness is a multidimensional concept. To reflect the definition of sustainable development that representatives of Member States agreed in the outcome document of the 2012 United Nations Conference on Sustainable Development, scores and rankings that capture economic, social and environmental aspects of inclusiveness have been computed as shown in table 3.9 for countries with available data. These scores can be combined to create a single score, thereby capturing all three dimensions of inclusiveness (*economic*, *social* and *environmental*).

Overall, data were available to compute the scores for each of the three dimensions of inclusiveness for 16 countries in the region covering the 1990s and the period 2000-2012. These 16 countries account for 92% of the region's population and 88% of its GDP. Table 3.9 shows the ranking for the period 2000-2012 when considering the following: (a) only social and economic inclusiveness; and (b) all three dimensions of inclusiveness. The addition of environmental inclusiveness produces a negative impact on the ranking of some countries. For instance, due to a lower ranking in the environmental dimension of inclusiveness during the period 2000-2012, the overall position of Cambodia, China, Indonesia, Sri Lanka and Tajikistan decreases once all three dimensions are combined.

Table 3.10 shows the score and rank of countries for overall inclusiveness for the 16 countries with available data for each of the economic, social and environmental dimensions. Overall, growth has been the most inclusive in Kazakhstan, the Russian Federation and Thailand and the least inclusive in Bangladesh, India, Nepal and Pakistan. The data suggest that growth has been inclusive over recent years at the macroeconomic level in the Asia-Pacific region, as indicated by the increases in index scores. Yet, some countries made more progress than others in increasing their scores. For instance, owing to the rapid increase in scores for China, the Islamic Republic of Iran and Sri Lanka that increased between the 1990s and the period 2000-2012, Tajikistan fell from fifth to eighth rank. More inclusive growth in China and the Islamic Republic of Iran also led to a decline in the ranking of the Philippines to tenth place. In addition, scores increased significantly in those economies ranked at the bottom of the table in the 1990s.

In this chapter, inclusive growth is defined in terms of broad social objectives which are not mutually exclusive: (a) increasing average standard of living of the population; (b) reducing inequality; (c) reducing extreme poverty; and (d) expanding and broadening opportunities. The sections above show that growth has been more inclusive at the country level; yet, large divergences in indicators of inclusiveness exist within countries between sexes and across the rural and urban sectors as well as between regions in countries.

Table 3.9. Ranking of countries for the period 2000-2012, excluding and including environmental inclusiveness

Country	Social and economic inclusiveness	Social, economic and environmental inclusiveness	Change in rank by environment
Kazakhstan	1	1	↔
Russian Federation	2	2	↔
Sri Lanka	3	5	↘
Thailand	4	3	↗
Malaysia	5	4	↗
China	6	7	↘
Tajikistan	7	8	↘
Iran (Islamic Republic of)	8	6	↗
Indonesia	9	11	↘
Turkey	10	9	↗
Philippines	11	10	↗
Cambodia	12	15	↘
Nepal	13	13	↔
India	14	14	↔
Bangladesh	15	12	↗
Pakistan	16	16	↔

Sources: ESCAP calculations.

Table 3.10. Scores and ranking of countries for inclusiveness of growth, 1990s and 2000-2012

Country	Social, economic and environmental inclusiveness			
	Score		Rank	
	1990-1999	2000-2012	1990-1999	2000-2012
Kazakhstan	0.80	0.82	1	1
Russian Federation	0.77	0.80	2	2
Thailand	0.73	0.79	3	3
Malaysia	0.72	0.78	4	4
Sri Lanka	0.71	0.77	6	5
Iran (Islamic Republic of)	0.66	0.73	8	6
China	0.65	0.73	10	7
Tajikistan	0.72	0.73	5	8
Turkey	0.65	0.72	9	9
Philippines	0.66	0.70	7	10
Indonesia	0.58	0.68	11	11
Bangladesh	0.54	0.60	12	12
Nepal	0.48	0.60	15	13
India	0.53	0.60	13	14
Cambodia	0.51	0.56	14	15
Pakistan	0.46	0.55	16	16

Sources: ESCAP calculations.

Of particular concern is that income inequalities are large and widening in many countries, as differences in access to critical public goods, such as education and health services, differ across income quintiles. With wealthier people being able to secure access to better education and better health services, thereby increasing their employment prospects, intergenerational inequities have the potential to be perpetuated unless inequalities in income are addressed.

Several reasons have been put forward to explain the widening of income inequalities. For one, market-oriented reforms that countries have embraced as they integrate more closely into the global economy have affected income distribution within countries. Thus, in many countries, real wage growth has lagged productivity growth, thereby contributing to a declining share of labour income in output and a widening of income inequality due to the more unequal distribution of capital (Zhuang, Kanbur and Rhee, 2014). Procyclical fiscal policy, increased financialization of the international economy and the privatization of State-owned enterprises that has diminished the role of the State, all have contributed to further widening of inequalities in income (Jaumotte, Lall and Papageorgiou, 2005).

To make growth more inclusive, therefore, requires concerted efforts of both the public sector and the private sector. Indeed, while the private sector plays a critical role in making growth more inclusive (see box 3.6), doing so requires revisiting the role of the State in development and strengthening its role.

Principally, the main role of the Government is to provide basic public goods and to create an enabling environment for the private sector to act as the main engine of growth in an economy. Principally, Governments should ensure that equality of opportunities exists, such as by broadening access to education and health services and by strengthening social safety nets, through a policy framework that fosters the creation of employment. Moreover, ensuring strong legal and regulatory frameworks, improving the coordination and accountability of various institutions and ensuring macroeconomic-financial stability through prudent policies should enable the private sector to nurture a strong spirit of entrepreneurship. This should be

Box 3.6. The role of the private sector in making growth more inclusive

The private sector plays a critical role in making growth more inclusive. Without a vibrant and strong private sector, tackling poverty and rising levels of inequality and creating jobs would not be possible. The private sector is the driving force behind economic growth, exports, employment and the generation of tax revenues, among other such aspects.

Thus, increased private sector participation drives economic growth through investment and business creation, innovation and knowledge transfer, and other multiplier effects from its operations and activities. As such, stronger private sector engagement can lead to increased trade, investment and financial sector linkages, which are critical to boost trade opportunities and ultimately create employment. By providing people with livelihoods and furnishing the means to lift them out of poverty, the private sector has the ability to make growth inclusive by generating decent jobs and creating income-earning opportunities for the working population. Indeed, about 90% of jobs in developing countries are created by the private sector, although only about one fourth of the working-age population in developing countries is engaged in productive and decent employment. In particular, small and medium-sized enterprises are important for generating jobs in these economies.

The private sector is also the primary source of tax revenues, providing Governments with the means to finance essential public goods and services. A stronger, more vibrant private sector is therefore able to deliver higher levels of tax revenues, thus enabling Governments to provide more and better public services, thus creating a virtuous circle.

The private sector is an important actor in terms of social development due to its role in the provision of health and education services. Furthermore, there is tremendous scope in advancing its role in managing public services, including water and sanitation services, and social funds for disability. At the same time, the private sector's role is becoming increasingly important in terms of creating an environmentally sustainable and inclusive development trajectory. For instance, while it is increasingly involved in the provision of energy services in developing countries, the private sector is also critical in developing new technologies that may mitigate the negative impact of development on the environment.

The private sector has a critical role to play in making growth more inclusive. However, market failures can prevent it from meeting its potential to do so, thus highlighting the need for public intervention and institutional solutions. For instance, property rights in land ownership may be fragmented due to, for instance, poorly defined land rights and multiple claims on land, which can cause market failure in the land market, thereby making it impossible for investors to expand investment in developing countries (Khan, 2012). In addition, large externalities in, for instance, human capital formation, require public intervention to ensure that good-quality education is available to all. Moreover, progressive taxation and a functioning social protection system are required to ensure a minimum degree of distributional equity.

supported by risk-tolerant financial institutions and legal systems that actively encourage businesses and the development of micro, small and medium-sized enterprises, especially by women entrepreneurs.

In addition, it is important that countries do not assign to fiscal policy the role of serving as a tool for reducing government deficits or restoring macroeconomic balance alone. Rather, its role as a powerful instrument for promoting employment, and thereby inclusive growth, must be recognized. Similarly, monetary policy is not just a means for controlling inflation; rather, it should be treated as a versatile instrument through which both the price and volume of credit, for instance, can be effectively used in the pursuit of development objectives.

Given the widespread nature of vulnerable employment, greater efforts must be made to foster employment if growth is to become more inclusive. In many countries, this means giving greater attention to the development of small and medium-sized enterprises in general, and the rural sector, especially agriculture, in particular as large proportions of the population live in this sector and as the incidence of poverty is generally higher in rural than in urban areas. Indeed, the rural non-farm sector was a major contributor to China's remarkable growth (Mukherjee and Zhang, 2007).

Despite the importance of agriculture in terms of providing livelihoods for large proportions of the population, in most developing countries in the region the services sector and industry were the primary drivers of growth, leading to a significant decline in the contribution of agriculture to the region's GDP (as shown previously in figure 3.6). As was argued in the *Survey* for 2008, addressing the neglect of agriculture is crucial for reducing poverty and inequality. One way to strengthen the role of agriculture is to diversify into high-value crops, so far limited to a few countries. In addition to focusing on quality and standards, investments in research and development and in human capital would significantly increase agricultural productivity (ESCAP, 2008).

However, developing the non-farm sector is just as important. Policies should therefore also emphasize development of the rural sector; ultimately, structural change in the economy should follow an agriculture-industry-service sequence rather than jumping from agriculture to services without concentrating on manufacturing. One way to do so would be by fostering rural industrialization through small-scale industries. This would require linkages between agricultural and non-agricultural sectors producing both backward-forward and production-consumption linkages within agriculture and between the agricultural and non-agricultural sectors. For instance, during the 1980s and 1990s the labour market in Bangladesh underwent significant diversification, especially in terms of access to non-farm activities, thus improving the returns to labour and wage rates in rural areas. The rising employment opportunities in the rural non-farm sector opened up new opportunities for addressing poverty dynamics in the rural areas and making growth more inclusive. The structural shift in the rural non-farm sector, especially since the 1990s, in favour of micro and small enterprises, instead of exclusive dependence on self-employment activities of the earlier period, created greater scope for engaging in wage labour activities, improved productivity and enhanced wages, thus leading to accelerated inclusive growth. In Bangladesh, agroprocessing and the marketing of processed food now have the potential to emerge as new engines of inclusive growth (Mujeri, 2014).

In addition, agricultural productivity growth and consumption linkages generated by increased rural incomes would stimulate the rural economy further. For instance, the additional income generated by the ready-made garments sector, which has registered phenomenal growth and has emerged as the leading industry of Bangladesh, has provided a boost in terms of demand, especially for services and other non-tradable goods. Since the large majority of garment workers are poor women, many of whom migrated from rural areas, their spending patterns largely favour the purchase of goods and services produced by the informal non-tradable sector (Osmani and others, 2003). The rapid emergence of this sector is thus an interesting example of how a rising industrial activity can create significant spillover effects on demand for non-tradable goods and services, creating positive impacts on poverty dynamics in both urban and rural areas and the development and diversification of small and medium-sized enterprises through backward and forward linkages.

Development of technology is also important for inclusive growth. For example, the spread of the so-called green revolution to the poorer states in India has shown its potential for reducing regional disparities in development. In addition, small-scale farmers have benefited from technology; the experience with information technology is encouraging as this technology may also offer the prospect for raising productivity in agriculture and industry.

Fostering rural development and rural industrialization requires an inclusive financial system that offers access to financial products and services, especially for the poor, including obtaining credit and insurance on favourable terms and conditions and accessing payment services for undertaking transactions and remittances in a secure and cost-effective manner. Financial development in general and financial inclusion in particular may affect the poor through two channels: aggregate growth and changes in the distribution of income (Beck, Demirgüç-Kunt and Levine, 2007). Better access to the financial system enables the poor to access greater opportunities to improve their lives by utilizing the money available in the formal financial system. Therefore, not only does such access help people to become better off, but it also contributes to economic growth and reduces poverty. In Indonesia, for example, financial inclusion is one of the most important factors in the development of small and medium-sized enterprises (Dartanto and Ikshan, 2014).

In practice, however, a significant share of the population, especially the poor and those in the rural sector, still remain excluded from accessing financial services offered by the formal financial sector. In Indonesia, for example, there is a strong canonical negative relationship between financial inclusion and the poverty rate at the provincial level. Provinces with a higher share of agricultural credit tend to have lower levels of inequality. This would suggest that a higher share of agricultural credit indicates an expanding agricultural sector, as agricultural credit enables farmers to invest in new technologies, such as mechanization, in addition to purchase essential inputs, such as fertilizer and seeds. A higher share of agricultural credit also enables them to expand their business, which would boost the sector and labor productivity, thereby narrowing the income gap between agricultural households and non-agricultural households (Dartanto, 2014).

In this regard, monetary policy can play an important role in fostering more inclusive growth, given its ability to affect the price and volume of credit. Financial regulation is also important for supporting a framework that encourages the development of a vibrant banking sector that caters to those currently marginalized.

Policymakers can also make growth more inclusive by targeting public expenditure to expand equality in opportunities. Indeed, econometric analysis shows that when Governments increase total public expenditure, social inclusiveness, as captured by the index presented in the section above, increases (annex table III). Such expenditure includes, for instance, increasing spending on such areas as health, education and social safety nets. It also includes attempts to make existing expenditure more efficient, more effective and more development-oriented. In some countries, such as Sri Lanka, growing inequality is explained mainly by the growing disparity in households' access to education and infrastructure (Kelegama and Jayaweera, 2011). An important dimension may also be to focus policy on regional economic development – paying special attention to helping the most deserving and vulnerable groups in each region – in order to bridge regional disparities.

Social protection programmes have been implemented throughout the region to help address the growing inequalities within countries. Several countries have introduced direct cash transfers to the poor as a mechanism to reduce extreme poverty. There are three types of such transfers: unconditional cash transfers; conditional cash transfers; and cash for work. One of the best known cash-for-work programmes in the region is that implemented under the Mahatma Gandhi National Rural Employment Guarantee Act 2005, through which all adults in each rural household are provided with a combined 100 days of employment at the minimum wage. The programme currently costs about 0.3% of GDP and provides about 50 million households with employment. Work programmes have also been initiated elsewhere, such as in Solomon Islands where the Rapid Employment Project has been operational since 2010; under this arrangement targeted vulnerable urban populations are assisted by increasing their incomes through the provision of short-term employment. Other conditional and unconditional cash transfer schemes that operate in the region include the Benazir Income Support Programme in Pakistan and *Jamkesmas*, a community health protection programme in Indonesia, which in 2013 had 86.4 million beneficiaries.

Governments need to increase the quality of their labour force in order to increase the employability and productivity of workers and to address the issue of inequality of opportunities. One way to do so is to expand investment in education. Another is to increase access to and the affordability of health-care systems. Indeed, public expenditure on health and education has a beneficial impact on social inclusiveness that is more than twice that of total public expenditure (annex table III).

Regarding expenditure on education, UNESCO has recommended that between 15% and 20% of total government expenditure be allocated to education. Yet, among the 40 Asian and Pacific countries and territories where data are available, only 14 currently meet the UNESCO target. Moreover, in terms of GDP, expenditure on education is relatively low in the region, with only two non-island-developing States, Thailand and Viet Nam, meeting the recommendation of spending at least 6% of GDP on education to ensure quality provision of learning and education.[22,23] Of course, simply expanding expenditure may not be the solution to address the gaps between boys and girls that exist in education if social and cultural barriers impede female enrolment, or if gender gaps are due to differences in income, as is the case in many countries in the region.

Governments also need to increase access to and the affordability of health systems. For instance, under the Sustainable Development Solutions Network initiative of the United Nations it is proposed that "…countries make progress to allocating at least 5% of national GDP as public financing for health (with low- and middle-income countries reducing by at least half the gap between 5% of GDP and current public funding)" in order to provide universal health care (UNSDNS, 2014). Yet, apart from small island developing States, which are likely to have high levels of health expenditure due to the lack of economies of scale, no developing

Asia-Pacific economy currently meets this goal. Universal access to health care can be provided at lower expenditure – such as is the case in Thailand, where universal health coverage is achieved by spending only 3.7% of GDP (equivalent to $136 per capita – less than the average health expenditure for lower-middle-income countries, which stood at $153) (WHO, 2010). Indeed, even a lower level of public expenditure on health equal to 3% of GDP was reached by only eight non-island developing economies in the region. In many economies, public expenditure does not even reach 1.5% of GDP, including in some of the larger economies, such as Bangladesh, India, Indonesia and Pakistan. In addition to increasing expenditure, other policies can be introduced to foster health performance. An important policy which has helped Sri Lanka, for instance, in retaining most of the qualified medical specialists and doctors in the country is the country's policy on private practice; it allows such professionals to engage in private practice after duty hours, away from government hospitals and clinics (McNay, Keith and Penrose, 2004). In addition, compulsory posting of all newly appointed doctors to all regions in the country and transferring them on a regular basis is another policy that has been adopted by Sri Lanka to improve the availability of medical personnel throughout the country.

The *Survey* for 2013 demonstrated how expenditure on health, education and social security is relatively low in many economies in the Asia-Pacific region due to the fact that existing expenditure is often not sufficiently development-oriented (ESCAP, 2013a). For instance, in many economies significant spending is devoted to defence: military expenditure totalled more than $230 billion in 10 countries in the East Asian region alone; in several countries, it exceeds that spent on health and education combined. Similarly, significant resources are devoted to subsidies, especially energy subsidies. In East Asia alone, fossil-fuel consumption subsidies amounted to $76 billion in 2012. In that year, subsidies on fuel alone reached 3% of GDP in Brunei Darussalam and Indonesia; 2.6% of GDP in Thailand; 2.5% of GDP in Viet Nam; and 2.4% of GDP in Malaysia. Clearly, countries could find ways to reduce such expenditure on non-development areas. Energy subsidies are often highly regressive; moreover, they encourage wastage and result in fuel-intensive forms of production. Importantly, poorly targeted energy subsidies have had little beneficial impact on either enhancing inclusive growth or reducing extreme poverty.

While curbing increasing levels of non-development expenditure and removing or reducing harmful subsidies are politically challenging tasks, low oil prices have enabled several countries to move forward in reducing regressive subsidies and boost expenditures on education, health and social protection. These policy measures will further support their efforts to attain fiscal consolidation and to release additional financial resources for inclusive growth. For example, the Government of Indonesia reduced fuel subsidies in November 2014 and eliminated petrol subsidies in January 2015. Similarly, in Malaysia fuel subsidies were removed in December 2014.

Reducing non-development expenditure would free important resources so that they could be used to strengthen social expenditure and address the large gaps in infrastructure that are impeding development of the region, in particular those of the rural sector, where in many countries supporting infrastructure for sustained and inclusive growth is urgently needed. Rural community governments in China, for instance, have provided critical public infrastructure in the form of roads, water and irrigation systems, energy etc., to the extent that regions with better infrastructure attracted more investment into the rural manufacturing sector, which in turn led to greater employment and higher revenues (Mukherjee and Zhang, 2007). As had been noted in the *Survey* for 1950, land tenure systems can impede rural development (ECAFE, 1951). In Papua New Guinea, for instance, land is owned by clans and can neither be alienated nor used as collateral for business loans. Thus, the mobilization of blocks of land for rural development is constrained by the fragmentation of ownership, the difficulties of identifying the "true" owners where there are disputes, and excessive "compensation" demands (Naidu, Matadradra and Epeli, 2014).

Yet, while reducing non-development expenditure would free important resources, in the region an overall limiting factor to making public expenditure more effective is the fact that tax revenues are quite low in many countries, especially as pervasive tax avoidance and evasion are contributing to the erosion of revenues (ESCAP, 2014e). Indeed, in the *Survey* for 2014 it was shown that untapped tax potential is quite significant in many economies, amounting to several percentage points of GDP (ESCAP, 2014b). Indeed, raising higher levels of revenue (as a percentage of GDP) does not have a significant impact on economic inclusiveness, as measured above (annex table III). This would suggest that tax policy has not been successful in redistributing income in the region. Nonetheless, higher levels of revenue have a highly significant impact on social inclusiveness, highlighting the point that raising more revenue (in a progressive way) to finance development-oriented expenditure would increase equal opportunities in the region. However, in some countries recent taxation reforms relating to a broadening of value-added taxes (VAT) have largely failed to address income inequality but have increased the gap between the "haves" and "have-nots".

3. CONCLUSIONS

The phenomenal growth that has been witnessed in Asia and the Pacific over the last few decades lifted millions of people out of extreme poverty. However, there is more to well-being and development than simply increasing levels of income and reducing levels of poverty. Rather, development and human welfare comprise a multidimensional concept that encompasses economic, social and environmental aspects.

By defining *inclusive growth* in terms of broad social objectives that include the need to: (a) increase average standards of living of the population; (b) reduce levels of inequality; (c) reduce extreme poverty; and (d) expand and broaden opportunities, this chapter has highlighted inclusiveness across the three dimensions of sustainable development. It has shown that across countries growth overall has been inclusive. Thus, in all 22 countries with available data, *social inclusiveness* improved more during the period 2000-2012 than in the 1990s. Similarly, in 20 of these countries, *economic inclusiveness* improved, and in 19 of 25 countries with data, *environmental inclusiveness* improved.

However, despite these overall improvements, the gap between the "haves" and the "have nots" within countries is widening. For one, greater economic inclusiveness is largely a result of countries' success in reducing rates of extreme poverty, masking the fact that compared with the 1990s, in most countries the richest 20% of the population are capturing a larger share of income than the poorest 20%. This is particularly true in the region's three most populous countries, China, India and Indonesia. Moreover, in addition to wide income gaps between rural and urban sectors as well as between different regions, there has also been a deterioration in labour markets, with fewer people in formal employment. At the same time, the analysis shows that, despite a general improvement in access to basic public services, including health and education, in all countries since the 1990s, opportunities within countries are largely determined by a person's economic circumstance or that of his or her parents.

If such dynamics persist, they will ultimately lead to a vicious cycle in which the better off benefit more from public services, such as health care and education, which in turn would increase their employment prospects, thereby widening the gap between them and those less well off. Concerted actions of the private and public sector are therefore needed to address this issue. This will necessitate making greater efforts to achieve equality in opportunities, including more equal access to education, health-care services and stronger social safety nets. In particular, it will entail developing a policy framework that fosters the creation of employment by supporting the development of micro, small, and medium-sized enterprises and by strengthening rural development and industrialization.

ANNEXES

Table I. GDP per capita in selected Asia-Pacific economies

(Constant 2005 United States dollars)

Country/area	1990	2013	Growth since 1990	Country/area	1990	2013	Growth since 1990
Afghanistan	232	424	76%	Micronesia (Federated States of)	1 969	2 455	25%
Armenia	1 146	2 310	101%	Mongolia	846	1 796	112%
Azerbaijian	1 669	3 253	95%	Nepal	233	409	75%
Bangladesh	270	625	132%	Pakistan	525	806	54%
Bhutan	643	2 037	21%	Palau	10 546	9 558	-9%
Brunei Darussalam	26 831	24 185	-10%	Papua New Guinea	728	1 111	53%
Cambodia	242	709	193%	Philippines	1 002	1 581	58%
China	483	3 583	642%	Republic of Korea	8 829	23 893	171%
Fiji	2 903	3 681	27%	Samoa	1 550	2 329	50%
Georgia	2 499	2 157	-14%	Singapore	16 554	36 898	123%
Hong Kong, China	17 566	33 534	91%	Solomon Islands	987	1 113	13%
India	403	1 165	189%	Sri Lanka	710	2 004	182%
Indonesia	840	1 810	115%	Tajikistan	719	481	-33%
Iran (Islamic Republic of)	1 801	3 312	74%	Thailand	1 572	3 438	119%
Kazakhstan	3 073	5 425	77%	Timor-Leste	438	816	87%
Kiribati	952	1 176	24%	Tonga	1 853	2 662	44%
Kyrgyzstan	699	625	-10%	Turkey	5 013	8 717	74%
Lao People's Democratic Republic	262	751	187%	Turkmenistan	2,192	3 557	62%
Macao, China	14 494	54 092	273%	Tuvela	1 782	2 648	49%
Malaysia	3 147	6 990	122%	Uzbekistan	547	899	64%
Maldives	2 871	4 926	72%	Vanuatu	1 843	2 110	14%
Marshall Islands	2 386	2 933	23%	Viet Nam	301	1 029	241%

Sources: ESCAP, based on World Bank, World Development Indicators. Available from http://data.worldbank.org/data-catalog/world-development-indicators.

Table II. Annual percentage change in poverty rate, GDP per capita and Gini coefficient

Trend	Country	Period	Poverty rate ($1.25/day)	GDP per capita	Gini coefficient
Faster decline in 2000s in inequality	Thailand	1990-2002	-15.0	3.3	-0.6
		2002-2010	-16.7	4.0	-0.8
Decline in inequality in 2000s at a slower rate	Armenia	1996-2002	-2.6	7.8	-3.6
		2002-2010	-20.2	7.5	-1.6
	Maldives[a]	1998-2004	-37.8	9.0	-8.3
		2004-2013	..	3.2	0.0
	Pakistan	1991-2002	-5.2	1.1	-0.8
		2002-2008	-8.5	3.5	-0.2
Decline in inequality in 2000s after expanding in 1990s	Azerbaijan	1995-2001	-14.6	6.6	0.7
		2001-2008	-31.9	16.7	-1.1
	Bangladesh	1996-2000	-4.4	3.3	0.4
		2000-2010	-3.0	4.4	-0.4
	Cambodia[b]	1994-2004	-1.6	5.2	1.1
		2004-2009	-13.2	6.5	-2.1
	China	1990-2002	-6.1	8.6	2.3
		2002-2009	-11.8	10.4	-0.2
	Iran (Islamic Republic of)	1990-1998	-13.0	2.2	0.1
		1998-2005	2.0	3.6	-2.0
	Kazakhstan	1993-2002	2.3	2.4	0.8
		2002-2009	-42.3	6.3	-2.6
	Malaysia	1992-1997	-19.7	6.5	0.6
		1997-2009	-97.3	1.7	-0.5
	Nepal	1996-2003	-3.5	1.7	3.2
		2003-2010	-10.3	3.0	-4.0
	Philippines	1991-2000	-3.4	1.0	0.6
		2000-2009	-2.2	2.5	-0.8
	Sri Lanka	1991-2002	-0.7	3.7	2.2
		2002-2010	-14.2	5.0	-1.5
	Tajikistan	1999-2003	-8.0	8.2	3.0
		2003-2009	-24.5	4.9	-0.9
	Turkey	1994-2002	-0.6	1.9	0.4
		2002-2010	-4.9	3.5	-0.8
	Viet Nam	1993-2002	-5.0	5.7	0.6
		2002-2008	-13.4	5.8	-0.9
Increase in inequality in 2000s after declining in 1990s	Indonesia[c]	1990-2002	-5.0	2.6	-0.9
		2002-2011	-6.4	4.2	2.8
	Kyrgyzstan	1993-2002	6.9	-0.6	-5.7
		2002-2011	-19.1	3.5	0.6
	Mongolia	1996-2002	..	2.3	-0.2
		2002-2008	..	7.4	1.8
	Russian Federation	1993-2002	-15.8	0.2	-3.3
		2002-2006	-100.0	7.8	1.7
Faster increase in inequality in 2000s than in 1990s	Lao People's Democratic Republic	1992-2002	-2.3	4.1	0.7
		2002-2008	-4.2	5.5	2.0
Slower increase in inequality in 2000s than in 1990s	Georgia	1996-2002	22.3	5.7	1.4
		2002-2010	1.7	6.2	0.5
	India	1994-2005	-1.5	4.7	0.7
		2005-2010	-4.7	6.9	0.3

Source: ESCAP, based on World Bank, World Development Indicators. Available from http://data.worldbank.org/data-catalog/world-development-indicators.

[a] GDP per capita covers period 2001-2004.
[b] Gini coefficient covers period 2002-2009.
[c] Gini coefficient covers period 1996-2002.

Table III. Sensitivity of ESCAP inclusiveness index - economic and social inclusiveness

Independent	Economic inclusiveness				Social inclusiveness			
variables	EQ1	EQ2	EQ3	EQ4	EQ5	EQ6	EQ7	EQ8
Economic growth	0.004*				-0.011			
	(1.95)				(-1.57)			
Total public expenditures		-0.002				0.008***		
		(-0.93)				(3.04)		
Tax revenue			0.002				0.022***	
			(0.49)				(4.52)	
Education and health public expenditures				0.007				0.019**
				(1.49)				(2.35)
Number of observations	47	41	37	47	59	54	43	61
F-statistics	3.79	0.87	0.24	2.23	2.45	9.27	20.43	5.53
(p-values)	(0.058)	(0.357)	(0.626)	(0.142)	(0.123)	(0.004)	(0.000)	(0.022)
R^2	0.078	0.022	0.007	0.047	0.041	0.151	0.332	0.086

Note: *, **, and *** refer respectively to significance levels of 10%, 5% and 1%.

Scoring of variable used for the measurement of inclusiveness

Calculating the composite indices requires scoring or rescaling all variables and aggregating variables by component (economic, social and environmental). A linear scaling from zero to one was used, as indicated in table IV. As all the components of inclusiveness are equally important, arithmetic averages are used to put all variables together by component and to aggregate the components.

Table IV. Rescaling of indicators comprising economic, social and environmental inclusiveness

Variables	Min.	Max.	Explanation	Formula
ECONOMIC OPPORTUNITIES				
GINI coefficient	0.01	0.99	Theoretical range boundaries are replaced by these values because they cannot be observed empirically.	$S = \frac{max\text{-}actual}{max\text{-}min}$
Ratio of income shares of the highest quintile by the lowest quintile	1	25	The figure 1 corresponds to equity, and 25 is 95th percentile at the global level.	$S = \frac{max\text{-}actual}{max\text{-}min}$
Poverty headcount ratio, $1.25 per day in 2005 PPP (percentage)	0	95	Based on global statistics.	$S = \frac{max\text{-}actual}{max\text{-}min}$
Ratio of female to male labour-force participation rate (percentage)	5	100	Based on global statistics.	$S = \frac{actual\text{-}min}{max\text{-}min}$
Unemployment (percentage)	0.25	40	Based on global statistics.	$S = \frac{max\text{-}actual}{max\text{-}min}$
ENVIRONMENTAL SUSTAINABILITY				
Improved sanitation facilities (percentage of population with access)	1	100	Based on global statistics.	$S = \frac{actual\text{-}min}{max\text{-}min}$
Improved water source (percentage of population with access)	1	100	Based on global statistics.	$S = \frac{actual\text{-}min}{max\text{-}min}$
Greenhouse gas emissions (percentage change per annum)	-18	40	Based on global statistics.	$S = \frac{max\text{-}actual}{max\text{-}min}$
Forest area (percentage change per annum)	-10	5	Based on global statistics.	$S = \frac{actual\text{-}min}{max\text{-}min}$
Fossil-fuel energy consumption (percentage change per annum)	-18	21	Based on global statistics (percentiles).	$S = \frac{max\text{-}actual}{max\text{-}min}$
SOCIAL OPPORTUNITIES				
Ratio of female to male secondary enrolment (percentage)	1	100	Based on global statistics.	$S = \frac{actual\text{-}min}{max\text{-}min}$
School enrolment, secondary (percentage gross)	5	105	Based on global statistics.	$S = \frac{actual\text{-}min}{max\text{-}min}$
Average years of schooling	0	13.3	UNDP, HDI method.	$S = \frac{actual\text{-}min}{max\text{-}min}$
Births attended by skilled health staff	4	100		$S = \frac{actual\text{-}min}{max\text{-}min}$
Mortality rate, under-5 (per 1,000 live births)	1	175	Based on global statistics (95th percentile).	$S = \frac{max\text{-}actual}{max\text{-}min}$

Source: ESCAP calculations.

Endnotes

1 The level of per capita income (in real terms) in Singapore was 90 times greater than that of Nepal in 2012, compared with 71 times larger at the beginning of the 1990s.

2 See, for example, *Economic and Social Survey of Asia and the Pacific* for 2013 and 2014.

3 See Asian Development Bank (2012).

4 Cobham and Sumner (2013) advocated comparing the ratio of the top 10% of a population's share of gross national income with that of the poorest 40% of the population's share. Using this ratio does not change the overall picture significantly: for the latest available data, 11 of 31 developing countries in the region would find themselves in the same comparative ranking as when comparing the ratio of the top to bottom income quintiles. An additional 15 countries would find themselves ranked up to two ranks higher or lower.

5 In the Federated States of Micronesia and the Marshall Islands, this ratio is more than 40 times as large. However, this determination is based on the most recent data, which are available only for 2000 and 1999 respectively.

6 To compare, this ratio is less than or equal to 4 in Norway, which is the highest-ranked country in the UNDP Human Development Index. It is below 4 in other Nordic countries, including Denmark, Finland and Sweden. In the Asia-Pacific region, it is less than or equal to 4 only in Afghanistan and Japan.

7 These economies include: Japan; Hong Kong, China; Indonesia; Malaysia; the Republic of Korea; Singapore; Taiwan Province of China; and Thailand. See World Bank (1993).

8 Thus, there is clear evidence that a decline in budget deficits is followed by increases in inequality, even after controlling for the impacts of recessions and slowdowns (Ball and others, 2013; Woo and others, 2013). Similarly, capital account liberalization is followed by a significant and persistent increase in inequality. Furceri and Loungani (2013) showed that the Gini coefficient increases by about 1% per year after liberalization and by 2% per year after five years. They also showed that the impact of capital account liberalization on inequality holds even after the inclusion of myriad other determinants of inequality.

9 Defined by ILO as measuring the proportion of own-account workers and contributing family members in total employment.

10 Derived from estimates based on ILO (2012).

11 The employment elasticity of growth is calculated as the ratio of the growth rate in employment to the growth rate in output. While Islam and Nazara (2000) demonstrated that year-over-year employment elasticities can exhibit a great deal of instability, the intensity is calculated here using the average over several periods, thus "ironing out" the year-to-year swings. According to Article 25 of the Universal Declaration of Human Rights, "Everyone has the right to a standard of living adequate for the health and well-being of himself and of his family, including food, clothing, housing and medical care and necessary social services, and the right to security in the event of unemployment, sickness, disability, widowhood, old age or other lack of livelihood in circumstances beyond his control" (emphasis added). Under Article 26, "Everyone has the right to education. Education shall be free, at least in the elementary and fundamental stages. Elementary education shall be compulsory. Technical and professional education shall be made generally available and higher education shall be equally accessible to all on the basis of merit".

12 According to Article 25 of the Universal Declaration of Human Rights, "Everyone has the right to a standard of living adequate for the health and well-being of himself and of his family, including food, clothing, housing and *medical care* and necessary social services, and the right to security in the event of unemployment, sickness, disability, widowhood, old age or other lack of livelihood in circumstances beyond his control" (emphasis added). Under Article 26, "Everyone has the right to education. Education shall be free, at least in the elementary and fundamental stages. Elementary education shall be compulsory. Technical and professional education shall be made generally available and higher education shall be equally accessible to all on the basis of merit".

[13] See UNESCO World Inequality Database on Education. Available from www.education-inequalities.org.

[14] Ibid.

[15] Several studies show the negative correlation between income inequality and environmental sustainability, including those by Baland, Bardhan and Bowles (2007) and Mikkelson, Gonzalez and Peterson (2007).

[16] See annex table IV for details on the methodology that was applied to rescale all variables and aggregate them.

[17] For this line of argumentation, see Barro and Lee (2013).

[18] See annex for details on the methodology that was applied to rescale and aggregate all variables.

[19] By the mid-1990s, the ready-made garments sector in Bangladesh increased its share to about 25% of the total value added and employed nearly 50% of the total workforce in medium and large-scale industries. Its share in total exports was barely 4% in 1983/84, but it exceeded 80% by the end of the 1990s.

[20] See “Continue with NREGA, economists urge Modi”, *The Hindu*, 14 October 2014. Available from www.thehindu.com/news/national/economists-write-to-narendra-modi-on-nrega/article6498323.ece.

[21] For details, see Oslo Declaration, which was adopted in Oslo on 18 December 2008. Available from www.unesco.org/education/Oslo_Declaration_final_17dec08.pdf.

[22] Note that the eighth meeting of the high-level group on education for all, in adopting the Oslo Declaration, committed to 6% of GNP; however, as GNP data are not available for many Asia-Pacific countries, GDP is used for the purpose of analysis.

[23] For details, see UNESCO and CONFINTEA VI (2009), p. 5, para. 14a. Available from www.unesco.org/fileadmin/MULTIMEDIA/INSTITUTES/UIL/confintea/pdf/working_documents/confinteavi_framework_en.pdf.

[24] Data are from IEA. Available from www.iea.org/subsidy/index.html.

[25] Ibid.

REFERENCES

Aguirre, D., and others (2012). *Empowering the Third Billion: Women and the World of Work in 2012.* San Francisco: Booz and Company.

Amiti, Mary, Oleg Itskhoki, and Jozef Konings (2014). Why hasn't the yen depreciation spurred Japanese exports?, 7 July. Available from http://libertystreeteconomics.newyorkfed.org/2014/07/why-hasnt-the-yen-depreciation-spurred-japanese-exports.html#.VLv5arAcSUk.

Anand, R., M.S. Mishra, and S.J. Peiris (2013). Inclusive growth: measurement and determinants. Working Paper, No. 13/135. Washington, D.C.: International Monetary Fund. Available from www.imf.org/external/pubs/ft/wp/2013/wp13135.pdf.

Anand, Rahul, and Volodymyr Tulin (2014). Disentangling India's investment slowdown. Working Paper, No. 14/47. Washington, D.C.: International Monetary Fund.

Anand, Rahul, and others (2014). Potential growth in emerging Asia. Working Paper, No. WP/14/2. Washington, D.C.: International Monetary Fund.

Andrés, Luis, Dan Biller, and Matías Herrera Dappe (2014a). Infrastructure gap in South Asia infrastructure needs, prioritization, and financing. Policy Research Working Paper, No. 7033. Washington, D.C.: World Bank.

_________ (2014b). Reducing poverty by closing South Asia's infrastructure gap. Working Paper, No. 86432. Washington, D.C.: World Bank. Available from http://documents.worldbank.org/curated/en/2013/12/19330904/reducing-poverty-closing-south-asias-infrastructure-gap.

Asian Development Bank (2012). *Asian Development Bank Outlook 2012.* Manila.

_________ (2013). *Bhutan: Making Progress on the Path to Prosperity.* Manila.

Asian Development Bank, and Asian Development Bank Institute (ADBI) (2009). *Infrastructure for a Seamless Asia.* Tokyo: ADBI. Available from http://adb.org/sites/default/files/pub/2009/2009.08.31.book.infrastructure.seamless.asia.pdf.

Asia-Pacific Economic Cooperation (2014). 2014 Leaders' Declaration: The 22nd APEC Economic Leaders' Declaration–Beijing Agenda for an Integrated, Innovative and Interconnected Asia-Pacific. Beijing, 11 November. Available from www.apec.org/Meeting-Papers/Leaders-Declarations/2014/2014_aelm.aspx.

Atkinson, A.B. (1970). On the measurement of inequality. *Journal of Economic Theory,* vol. 2, No. 3, pp. 244-263.

Atkinson, A.B., and E. Marlier (2010). *Analysing and Measuring Social Inclusion in a Global Context*. United Nations publication, Sales No. E.09.IV.16. Available from www.un.org/esa/socdev/publications/measuring-social-inclusion.pdf.

Auer, J, and L. Vignold-Majal (2014). Falling oil price highlights end of commodities supercycle. Research, 22 December. Frankfurt: Deutsche Bank.

Balakrishnan, R., C. Steinberg, and M. Syed (2013). The elusive quest for inclusive growth: growth, poverty, and inequality in Asia. Working Paper, No. 13/152. Washington, D.C.: International Monetary Fund.

Baland, J.M., P.K. Bardhan, and S. Bowles, eds. (2007). *Inequality, Cooperation, and Environmental Sustainability*. Princeton, New Jersey: Princeton University Press.

Ball, Laurence, and others (2013). The distributional effects of fiscal consolidation. Working Paper, No. 13/151. Washington, D.C.: International Monetary Fund.

Banerjee, A.V., and E. Duflo (2003). Inequality and growth: what can the data say? *Journal of Economic Growth*, vol. 8, No. 3, pp. 267-299.

Bank for International Settlements (2010). Group of Central Bank Governors and Heads of Supervision reinforces Basel Committee reform package, Press Release, 11 January. Available from www.bis.org/press/p100111.htm.

Bank Indonesia (2015). Indonesia's end Q4/2014 external debt decreased. Available from www.bi.go.id/en/ruang-media/info-terbaru/Pages/Utang-Luar-Negeri-Indonesia-Triwulan-IV2014-Menurun.aspx.

Barro, R.J., and J.W. Lee (2013). A new data set of educational attainment in the world, 1950-2010. *Journal of Development Economics*, vol. 104, pp. 184-198.

Beck, Thorsten, A. Demirgüç-Kunt, and Ross Levine (2007). Finance, inequality, and the poor. *Journal of Economic Growth*, vol. 12, No. 1, pp. 27-49.

Bedford, Juliet, and others (2013). Access to health services: analysing non-financial barriers in Ghana, Bangladesh, Vietnam and Rwanda using qualitative methods – a review of the literature. Maternal, Newborn and Child Health Working Paper, August. New York: UNICEF.

Brazil, Ministry of External Relations (2014). Agreement on the New Development Bank, Fortaleza, July 15, VI BRICS Summit, Press Release. Available from http://brics6.itamaraty.gov.br/media2/'press-releases/219-agreement-on-the-new-development-bank-fortaleza-july-15.

Canuto, O. (2014). The commodity super cycle: is this time different? *Economic Premise*, No. 150, pp. 1-3.

Chami, R., and others (2008). Macroeconomic consequences of remittances. Occasional Paper, No. 259. Washington, D.C.: International Monetary Fund.

Claessens, Stijn (2014). An overview of macroprudential policy tools. Working Paper, No. WP/14/214. Washington, D.C.: IMF. Available from www.imf.org/external/pubs/ft/wp/2014/wp14214.pdf.

Cobham, A., and A. Sumner (2013). Putting the Gini back in the bottle? "The Palma" as a policy-relevant measure of inequality. London: King's College London. Available from www.kcl.ac.uk/aboutkings/worldwide/initiatives/global/intdev/people/Sumner/Cobham-Sumner-15March2013.pdf.

Costantini, V., and C. Martini (2010). A modified environmental Kuznets curve for sustainable development assessment using panel data. *International Journal of Global Environmental Issues*, vol. 10, No. 1, pp. 84-122.

Dartanto, Teguh (2014). Why is growth less inclusive in Indonesia? Draft Economics Working Paper. Manila: Asian Development Bank.

Dartanto, Teguh, and Mohamad Ikshan (2014). Making growth more inclusive in Indonesia: challenges, opportunities and direction. Background paper prepared for the *Economic and Social Survey of Asia and the Pacific 2015*. Bangkok: ESCAP.

Das, S.B. (2015). AEC not just about the economics. *East Asia Forum*, 31 January. Available from www.eastasiaforum.org/2015/01/31/aec-not-just-about-the-economics/.

de Mello, Luiz, and Mark A. Dutz (2012). *Promoting Inclusive Growth: Challenges and Policies*. Paris: Organisation for Economic Co-operation and Development and World Bank.

Ding, Ding, and others (2014). Estimating Sri Lanka's potential output. Working Paper, No. 14/40. Washington, D.C.: International Monetary Fund.

Djamalov, Bekhzod, and Bakhodur Eshonov (2014). A country study on making growth more inclusive: comparing with Central Asian countries. Background paper prepared for the *Economic and Social Survey of Asia and the Pacific 2015*. Bangkok: ESCAP.

Dollar, D., and A. Kraay (2002). Growth is good for the poor. *Journal of Economic* Growth, vol. 7, No. 3, pp. 195-225.

Economist Intelligence Unit (2012). *Women's Economic Opportunity 2012: A Global Index and Ranking from the Economist Intelligence Unit*. London.

Elborgh-Woytek, K., and others (2013). Women, work and the economy: macroeconomic gains from gender equality. Staff Discussion Note, No. 13/10. Washington, D.C.: IMF.

Fan, S., C. Chen-Kang, and A. Mukherjee (2005). Rural and urban dynamics and poverty: evidence from China and India. Discussion Paper, No. 196. Washington, D.C.: International Food Policy Research Institute.

Fidelity Worldwide Investment (2014). Emerging Asia: urbanisation driving secular infrastructure story, April. Available from www.fidelity.com.sg/pdf/market_commentaries/2014-04-24%20Asian%20Urbanisation.pdf.

Frankel, Jeffrey A. (2012). The natural resource curse: a survey of diagnoses and some prescriptions. HKS Faculty Research Working Paper Series, RWP12-014. Cambridge, MA: Harvard University, John F. Kennedy School of Government.

Frazer, G. (2006). Inequality and development across and within countries. *World Development*, vol. 34, No. 9, pp. 1459-1481.

Freire, C. (2011). Productive capacities in Asia and the Pacific. MPDD Working Papers, No. 11/17. Bangkok: ESCAP.

Fry, Gerald (2013). Student performances in PISA tests a wake-up call for Thailand. *The Nation*, 23 December.

Furceri, Davide, and Prakash Loungani (2013). Who let the Gini out? *Finance and Development*, vol. 50, No. 4 (December), pp. 25-27. Available from www.imf.org/external/pubs/ft/fandd/2013/12/furceri.htm.

Galbraith, J.K. (2010). Inequality and economic and political change: a comparative perspective. *Cambridge Journal of Regions, Economy and Society*, vol. 4, No. 1, pp. 13-27.

Gallup, J. (2012). Is there a Kuznets curve? Department of Economics Working Paper. Portland, Oregon: Portland State University. Available from www.pdx.edu/econ/sites/www.pdx.edu.econ/files/kuznets_complete.pdf.

Ghosh, Jayati (2010). Poverty reduction in China and India: policy implications of recent trends. Working Paper, No. 92 (ST/ESA/2010/DWP/92). New York: United Nations Department of Economic and Social Affairs.

Groff, S. (2014). Asean's infrastructure crisis. *The Wall Street Journal*, 28 July. Available from www.wsj.com/articles/groff-aseans-infrastructure-crisis-1406566174.

Gui-Diby, Steve (forthcoming, a). Determinants of innovation in North and Central Asia. Working Paper. Bangkok: ESCAP. .

___________ (forthcoming, b). Determinants of remittances in North and Central Asia. Working Paper. Bangkok: ESCAP.

Gunatilake, Herath, and David Roland-Holst (2013). Energy policy options for sustainable development in Bangladesh. Economics Working Paper Series, No. 359. Manila: ADB.

Gylfason, Thorvaldur, Tryggvi Thor Herbertsson, and Gylfi Zoega (1999). A mixed blessing: natural resources and economic growth. *Macroeconomic Dynamics*, vol. 3, No. 2 (June), pp. 204-225.

Hongkong and Shanghai Banking Corporation (HSBC) (2013). Asia infrastructure shortfall. HSBC Global Connections, 4 June. Available from https://globalconnections.hsbc.com/us/en/articles/asia-infrastructure-shortfall.

___________ (2014). Asia central bank guide 2014. HSBC Global Research, June. Available from www.btinvest.com.sg/system/assets/25622/Asian_Central_banks.PDF.

Huynh, P., and S. Kapsos (2013). *Economic Class and Labour Market Inclusion: Poor, Vulnerable and Middle Class Workers in Developing Asia and the Pacific*. Bangkok: ILO.

IMS Institute for Healthcare Informatics (2013). *Understanding Healthcare Access in India. What is the Current State?* Parsippany, New Jersey. Available from www.imshealth.com/deployedfiles/imshealth/Global/Content/Corporate/IMS%20Institute/India/Understanding_Healthcare_Access_in_India.pdf.

India, Central Electricity Authority (2014). *Load Generation Balance Report 2014-15*. New Delhi. Available from www.cea.nic.in/reports/yearly/lgbr_report.pdf.

International Energy Agency (2014). *World Energy Outlook 2014.* Paris: Organisation for Economic Co-operation and Development and IEA.

International Labour Organization (2012). *Global Employment Trends 2012: Preventing a Deeper Jobs Crisis*. Geneva.

___________ (2014). Trends econometric models, October.

___________ (2015). *World Employment and Social Outlook: Trends 2015*. Geneva.

International Labour Organization, and Asian Development Bank (2014). *ASEAN Community 2015: Managing Integration for Better Jobs and Shared Prosperity*. Bangkok.

International Monetary Fund (2012). *World Economic Outlook April 2012: Growth Resuming, Dangers Remain*. Washington, D.C.

___________ (2014). Global housing watch: quarterly update, October. Washington, D.C. Available from www.imf.org/external/research/housing/report/pdf/1014.pdf.

Islam, I., and S. Nazara (2000). Estimating employment elasticity for the Indonesian economy. Technical Note on the Indonesian Labour Market. Jakarta: International Labour Office.

Japan, Ministry of the Environment (2014). Bringing development and climate together in Asia. Asian Co-benefits Partnership White paper 2014. Tokyo: Asian Co-benefits Partnership. Available from http://pub.iges.or.jp/modules/envirolib/upload/5082/attach/ACPwhitepaper_FY2013.pdf.

Jaumotte, F., S. Lall, and C. Papageorgiou (2005). Rising income inequality: technology, or trade and financial globalization? Working Paper, No. 08/185. Washington, D.C.: International Monetary Fund.

Kakwani, Nanak (2014). Inclusive growth in Asia: framework and measurement. Background paper prepared for the *Economic and Social Survey of Asia and the Pacific 2015*. Bangkok: ESCAP.

Kelegama, Saman (2014). Making growth more inclusive: Sri Lanka country study. Background paper prepared for the *Economic and Social Survey of Asia and the Pacific 2015*. Bangkok: ESCAP.

Kelegama, Saman, and Roshini Jayaweera (2011). Inclusive growth in Sri Lanka. Draft paper. Colombo: Institute of Policy Studies of Sri Lanka. Available from http://ris.org.in/images/RIS_images/pdf/Kelegama_paper.pdf.

Khan, Mushtaq H. (2012). The political economy of inclusive growth. In *Promoting Inclusive Growth: Challenges and Policies*, Luiz de Mello and Mark A. Dutz, eds. Paris: Organisation for Economic Co-operation and Development and World Bank.

Khandker, Shahidur, Mark Pitt, and Nobuhiko Fuwa (2003). Subsidy to promote girls' secondary education: the female stipend program in Bangladesh. MPRA Paper, No. 23688. Germany: University Library of Munich. Available from mpra.ub.uni-muenchen.de/23688/.

Kniivilä, Matleena (2007). Industrial development and economic growth: implications for poverty reduction and income inequality. In *Industrial Development for the 21st Century*: *Sustainable Development Perspectives*. United Nations publication, Sales No. 07.II.A.1.

Korea Development Institute (2014). *KDI Economic Outlook 2014- 2nd Half*. Sejong. Available from www.kdi.re.kr/report/report_class_e2.jsp?pub_no=13865. (In Korean).

Kruk, M.E., M.R. Prescott, and S. Galea (2008). Equity of skilled birth attendant utilization in developing countries: financing and policy determinants. *American Journal of Public Health*, vol. 98, No. 1, p. 142.

Kruk, M.E., and others (2007). Health care financing and utilization of maternal health services in developing countries. *Health Policy and Planning*, vol. 22, No. 5, pp. 303-310.

Kuznets, S. (1955). Economic growth and income inequality. *American Economic Review*, vol. XLV, No. 1, pp. 1-28. Available from www.aeaweb.org/aer/top20/45.1.1-28.pdf.

Lebovits, David, and Ainsley Woolrich (2015). U.S.: "Fed"-ing the needle, *Market Bulletin*, 19 March. J.P. Morgan Asset Management.

Lundberg, M., and L. Squire (2003). The simultaneous evolution of growth and inequality. *Economic Journal*, vol. 113, No. 487, pp. 326-344.

McKinley, T. (2010). Inclusive growth criteria and indicators: an inclusive growth index for diagnosis of country progress. Working Paper, 14. Manila: Asian Development Bank.

McMillan, Margaret, and Dani Rodrik (2011). Globalization, structural change and productivity growth. Working Paper, No. w17143. Cambridge, MA: National Bureau of Economic Research.

McNay, Kirsty, Regina Keith, and Angela Penrose (2004). *Bucking the Trend: How Sri Lanka Has Achieved Good Health at Low Cost – Challenges and Policy Lessons for the 21st Century.* London: Save the Children.

Medas, P.A., and D. Zakharova (2009). A primer on fiscal analysis in oil-producing countries. Working Paper, No. WP/09/56. Washington, D.C.: IMF.

Mikkelson, G.M., A. Gonzalez, and G.D. Peterson (2007). Economic inequality predicts biodiversity loss. *PLoS ONE*, vol. 2, No. 5, e444.

Moïsé, Evdokia, and Silvia Sorescu (2013). Trade facilitation indicators: the potential impact of trade facilitation on developing countries' trade. Trade Policy Papers, No 144. Geneva: OECD.

Mujeri, Mustafa K. (2014). Making growth more inclusive in Asia and the Pacific: a case study of Bangladesh. Background paper prepared for the Economic and Social Survey of Asia and the Pacific 2015. Bangkok: ESCAP.

Mukherjee, A., and X. Zhang (2007). Rural industrialization in China and India: role of policies and institutions. *World Development*, vol. 35, No. 10, pp. 1621-1634.

Naidu, Vijay, Anawaite Matadradra, and Sela Epeli (2014). Country study on making growth more inclusive – Papua New Guinea. Background paper prepared for the *Economic and Social Survey of Asia and the Pacific 2015*. Bangkok: ESCAP.

Ng, Thiam Hee (2015). Five bond market trends to watch out for in 2015, 19 January. Available from http://blogs.adb.org/blog/five-bond-market-trends-watch-out-2015.

Osmani, S.R, and others (2003). *The Macroeconomics of Poverty Reduction: The Case of Bangladesh.* Dhaka and Kathmandu: UNDP Asia-Pacific Regional Programme of Macroeconomics of Poverty Reduction.

Ostry, M.J.D., M.A. Berg, and M.C.G. Tsangarides (2014). *Redistribution, Inequality, and Growth.* Washington, D.C.: International Monetary Fund.

Pargal, Sheoli, and Sudeshna Ghosh Banerjee (2014). More power to India: the challenge of distribution. India Power Sector Diagnostic Review Report, No. ACS9203. Washington, D.C.: World Bank.

Plummer, M., and S.Y. Chia, eds. (2009). *Realizing the ASEAN Economic Community: A Comprehensive Assessment*. Singapore: Institute of Southeast Asian Studies.

Pregin (2015). Public-private partnerships in Asian infrastructure deals, 8 January . Available from www.preqin.com/blog/101/10523/ppp-asian-infrastructure-deals.

Pritchett, L. (2000). Understanding patterns of economic growth: searching for hills among plateaus, mountains, and plains. *World Bank Economic Review*, vol. 14, No. 2, pp. 221-250.

Rahman, Shamsur M., Abu Shahin M. Ashaduzzaman, and Md. Mizanur Rahman (2005). Poor people's access to health services in Bangladesh: focusing on the issues of inequality. Paper presented at the Workshop on Health Care for the Poor in Asia. Beijing, 5-7 December.

Ravallion, M. (2012). Troubling tradeoffs in the human development index. *Journal of Development Economics*, vol. 99, No. 2, pp. 201-209.

Reserve Bank of India (2014). India's external debt as at March 2014, 30 June. Available from http://rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=31521.

Sachs, J., and A. Warner (2001). Natural resources and economic development: the curse of natural resources. *European Economic Review*, No. 45. pp. 827-838.

Sauvant, Karl P., and Victor Zitian Chen (2014). China's regulatory framework for outward foreign direct investment. *China Economic Journal*, vol. 7, No. 1, pp. 141-163.

Schaechter, A., and others (2012). Fiscal rules in response to the crisis – towards the 'next-generation' rules. A new dataset. Working Paper, No. 12/187. Washington, D.C.: IMF.

Schmidt-Hebbel, Klaus (2012). Fiscal policy for commodity exporting countries: Chile's experience. Instituto de Economia Working Paper, No. 415. Santiago: Catholic University of Chile.

Schott, J. (2014). Asia-Pacific economic integration: projecting the path forward. Washington, D.C.: Peterson Institute for International Economics. Available from www.iie.com/publications/papers/schott201404APEC-FTAPP.pdf.

Speakman, John (2012). SOE reform: time for serious corporate governance. Policy Paper Series on Pakistan, No. PK 04/12. Washington, D.C.: World Bank.

Sugden, Craig (2010). Is growth in Asia and the Pacific inclusive? Economics Working Paper, No. 317. Manila: Asian Development Bank.

Tangcharoensathien, V., and others (2011). Health-financing reforms in Southeast Asia: challenges in achieving universal coverage. *Lancet*, vol. 377, No. 9768, pp. 863-873.

Trimble, Chris, Nobuo Yoshida, and Mohammad Saqib (2011). Rethinking electricity tariffs and subsidies in Pakistan. Report, No. 62971-PK. Washington, D.C.: World Bank.

Tuladhar, Raju, Chandan Sapkota, and Naveen Adhikari (2014). Effects of migration and remittance income on Nepal's agriculture yield. South Asia Working Paper, No. 27. Manila: ADB.

United Nations (1995). World Summit for Social Development. New York. Available from www.un.org/esa/socdev/wssd/text-version/.

___________ (2014a). Report of the Open Working Group on Sustainable Development Goals. Available from www.un.org/ga/search/view_doc.asp?symbol=A/68/L.61&referer=/english/&Lang=E.

___________ (2014b). The road to dignity by 2030: ending poverty, transforming all lives and protecting the planet. Synthesis Report of the Secretary-General on the Post-2015 Agenda. Available from www.un.org/ga/search/view_doc.asp?symbol=A/69/700&referer=/english/&Lang=E.

___________ (2014c). *Sustaining Progress on Population and Development in Asia and the Pacific: 20 Years after ICPD.* ST/ESCAP/2670. Bangkok: ESCAP and ICPD. Available from www.unescap.org/sites/default/files/SDD_PUB_ICPD-report-e_0.pdf.

United Nations, Economic Commission for Asia and the Far East (1951). *Economic Survey of Asia and the Far East 1950*. Sales No. 1951.II.F.4

United Nations, Economic and Social Commission for Asia and the Pacific (1980). *Economic and Social Survey of Asia and the Pacific 1979*. Sales No. E.80.II.F.1.

___________ (2008). *Economic and Social Survey of Asia and the Pacific: Sustaining Growth and Sharing Prosperity*. Sales No. E.08.II.F.7.

___________ (2012a). *Asia-Pacific Trade and Investment Report 2012: Recent Trends and Developments*. ST/ESCAP/2650. Bangkok.

___________ (2012b). *Low Carbon Green Growth Roadmap for Asia and the Pacific: Turning Resource Constraints and the Climate Crisis into Economic Growth Opportunities.* ST/ESCAP/2631. Bangkok.

___________ (2013a). *Economic and Social Survey of Asia and the Pacific 2013: Forward-Looking Macroeconomic Policies for Inclusive and Sustainable Development.* Sales No. E.13.II.F2.

___________ (2013b). *Ministerial Declaration and Plan of Action on Regional Cooperation for Enhanced Energy Security and the Sustainable Use of Energy in Asia and the Pacific*. Bangkok.

___________ (2014a). *Asia-Pacific Trade and Investment Report 2014: Recent Trends and Developments*. Sales No. E.15.II.F.2. Available from www.unescap.org/resources/asia-pacific-trade-and-investment-report-2014-recent-trends-and-developments.

___________ (2014b). *Economic and Social Survey of Asia and the Pacific 2014: Regional Connectivity for Shared Prosperity*. Sales No. E.14.II.F.4.

___________ (2014c). Fostering sustainable development in Asia and the Pacific: note by the Secretariat. Background paper for the Asia-Pacific Forum on Sustainable Development. Pattaya, Thailand, 19-21 May. Available from www.un.org/ga/search/view_doc.asp?symbol=E/ESCAP/FSD/1.

___________ (2014d). *Statistical Yearbook for Asia and the Pacific 2014*. ST/ESCAP/2704. Bangkok.

___________ (2014e). Sustainable development financing: perspectives from Asia and the Pacific. Background paper prepared for the Asia-Pacific Outreach Meeting on Sustainable Development Financing. Jakarta, 10-11 June. Available from www.unescap.org/events/asia-pacific-outreach-meeting-sustainable-development-financing.

___________ (2015a). *Economic and Social Survey of Asia and the Pacific 2014 Year-end Update*. ST/ESCAP/2705. Bangkok.

___________ (2015b). Overview of natural disasters and their impacts in Asia and the Pacific, 1970-2014. Technical Paper, March. Bangkok.

___________ (forthcoming, a). *Balancing the Three Dimensions of Sustainable Development: From Integration to Implementation*. Bangkok.

___________ (forthcoming, b). *Gender Equality and Women's Empowerment in Asia and the Pacific*. Bangkok.

United Nations Development Programme (1990). *Human Development Report 1990: Concept and Measurement of Human Development*. New York.

United Nations Educational, Scientific and Cultural Organization (2014). *The United Nations World Water Development Report 2014*, vol. 1, *Water and Energy*. Paris.

United Nations Educational, Scientific and Cultural Organization , and CONFINTEA VI (2009). Harnessing the power and potential of adult learning and education for a viable future: Belem Framework for Action. Preliminary draft. Paris.

United Nations Human Settlements Programme, and United Nations Economic and Social Commission for Asia and the Pacific (2010). *The State of Asian Cities 2010/11*. Fukuoka: UN-HABITAT.

United Nations Sustainable Development Solutions Network (UNSDNS) (2014). Health in the framework of sustainable development: technical report for the post-2015 development agenda. Report prepared by the Thematic Group on Health for All of the Sustainable Development Solutions Network. Available from unsdsn.org/wp-content/uploads/2014/02/Health-For-All-Report.pdf.

Woetzel, J., and others (2014). *Three Paths to Sustained Economic Growth in Southeast Asia*. Singapore: McKinsey & Company.

Woo, Jaejoon, and others (2013). Distributional consequences of fiscal consolidation and the role of fiscal policy: what do the data say? Working Paper, No. 13/195. Washington, D.C.: IMF.

World Bank (1993). The East Asian miracle: economic growth and public policy. Washington, D.C.

___________ (2010). *Innovation Policy: A Guide for Developing Countries*. Washington, D.C.

___________ (2011). CPIA 2011 criteria. Washington, D.C. Available from www.worldbank.org/ida/papers/CPIAcriteria2011final.pdf.

___________ (2014). Country partnership strategy for the Islamic Republic of Pakistan for the period FY 2015-19. Report, No. 84645-PK. Washington, D.C.

___________ (2015). *Global Economic Prospects: Having Fiscal Space and Using It*. Washington, D.C. Available from www.worldbank.org/content/dam/Worldbank/GEP/GEP2015a/pdfs/GEP15a_web_full.pdf.

World Economic Forum, and PricewaterhouseCoopers (2012). *Strategic Infrastructure: Steps to Prioritise and Deliver Infrastructure Effectively and Efficiently*. Geneva: World Economic Forum. Available from www3.weforum.org/docs/WEF_IU_StrategicInfrastructure_Report_2012.pdf.

World Health Organization (2009). *Health Financing Strategy for the Asia Pacific Region*. Geneva.

___________ (2010). *The World Health Report: Health Systems Financing – The Path to Universal Coverage*. Geneva. Available from www.who.int/whr/2010/en/index.html.

___________ (2014). Guidelines for indoor air quality: household fuel combustion. Available from www.who.int/indoorair/guidelines/hhfc/FAQs_Nov2014.pdf.

World Health Organization, and Lao People's Democratic Republic, Ministry of Health (2012). Health service delivery profile: Lao PDR. Available from www.wpro.who.int/health_services/service_delivery_profile_laopdr.pdf.

World Health Organization, and Papua New Guinea, National Department of Health (2012). Health service delivery profile: Papua New Guinea. Available from www.wpro.who.int/health_services/service_delivery_profile_papua_new_guinea.pdf.

World Trade Organization (2014). Modest trade growth anticipated for 2014 and 2015 following two year slump, Press Release, No. 721, 14 April. Available from www.wto.org/english/news_e/pres14_e/pr721_e.htm.

Zhuang, J., R. Kanbur, and C. Rhee (2014). What drives Asia's rising inequality? In *Inequality in Asia and the Pacific: Trends, Drivers, and Policy Implications*, Ravi Kanbur, Changyoung Rhee, and Jozhong Zhuang, eds. Manila: Asian Development Bank.

Since the 1957 issue, the *Economic and Social Survey of Asia and the Pacific* has, in addition to a review of the current situation of the region, contained a study or studies of some major aspect or problem of the economies of the Asian and Pacific region, as specified below:

1957: Postwar problems of economic development
1958: Review of postwar industrialization
1959: Foreign trade of ECAFE primary exporting countries
1960: Public finance in the postwar period
1961: Economic growth of ECAFE countries
1962: Asia's trade with western Europe
1963: Imports substitution and export diversification
1964: Economic development and the role of the agricultural sector
1965: Economic development and human resources
1966: Aspects of the finance of development
1967: Policies and planning for export
1968: Economic problems of export-dependent countries. Implications of economic controls and liberalization
1969: Strategies for agricultural development. Intraregional trade as a growth strategy
1970: The role of foreign private investment in economic development and cooperation in the ECAFE region. Problems and prospects of the ECAFE region in the Second Development Decade
1971: Economic growth and social justice. Economic growth and employment. Economic growth and income distribution
1972: First biennial review of social and economic developments in ECAFE developing countries during the Second United Nations Development Decade
1973: Education and employment
1974: Mid-term review and appraisal of the International Development Strategy for the Second United Nations Development Decade in the ESCAP region, 1974
1975: Rural development, the small farmer and institutional reform
1976: Biennial review and appraisal of the International Development Strategy at the regional level for the Second United Nations Development Decade in the ESCAP region, 1976
1977: The international economic crises and developing Asia and the Pacific
1978: Biennial review and appraisal at the regional level of the International Development Strategy for the Second United Nations Development Decade
1979: Regional development strategy for the 1980s
1980: Short-term economic policy aspects of the energy situation in the ESCAP region
1981: Recent economic developments in major subregions of the ESCAP region
1982: Fiscal policy for development in the ESCAP region
1983: Implementing the International Development Strategy: major issues facing the developing ESCAP region
1984: Financing development
1985: Trade, trade policies and development
1986: Human resources development in Asia and the Pacific: problems, policies and perspectives
1987: International trade in primary commodities
1988: Recent economic and social developments
1989: Patterns of economic growth and structural transformation in the least developed and Pacific island countries of the ESCAP region: implications for development policy and planning for the 1990s
1990: Infrastructure development in the developing ESCAP region: needs, issues and policy options
1991: Challenges of macroeconomic management in the developing ESCAP region
1992: Expansion of investment and intraregional trade as a vehicle for enhancing regional economic cooperation and development in Asia and the Pacific
1993: Fiscal reform. Economic transformation and social development. Population dynamics: implications for development
1995: Reform and liberalization of the financial sector. Social security
1996: Enhancing the role of the private sector in development. The role of public expenditure in the provision of social services
1997: External financial and investment flows. Transport and communications
1998: Managing the external sector. Growth and equity
1999: Social impact of the economic crisis. Information technology, globalization, economic security and development
2000: Social security and safety nets. Economic and financial monitoring and surveillance
2001: Socio-economic implications of demographic dynamics. Financing for development
2002: The feasibility of achieving the Millennium Development Goals in Asia and the Pacific. Regional development cooperation in Asia and the Pacific
2003: The role of public expenditure in the provision of education and health. Environment-poverty nexus revisited: linkages and policy options
2004: Poverty reduction strategies: tackling the multidimensional nature of poverty
2005: Dynamics of population ageing: how can Asia and the Pacific respond?
2006: Emerging unemployment issues in Asia and the Pacific: rising to the challenges
2007: Gender inequality continues – at great cost
2008: Unequal benefits of growth – agriculture left behind
2009: Triple threats to development: food, fuel and climate change policy challenges
2010: Multiple imbalances and development gaps as new engines of growth. A regional policy agenda for regaining the dynamism
2011: Regional connectivity and economic integration. Building the productive capacity of the least developed countries
2012: Living with high commodity prices
2013: Developmental macroeconomics: the critical role of public expenditure. Investing in inclusive and sustainable development
2014: Domestic resource mobilization: options for expanding fiscal space

READERSHIP SURVEY

The Macroeconomic Policy and Development Division of ESCAP is undertaking an evaluation of this publication, *Economic and Social Survey of Asia and the Pacific 2015*, with a view to making future issues more useful for our readers. We would appreciate it if you could complete this questionnaire and return it, at your earliest convenience, to:

Director
Macroeconomic Policy and Development Division
ESCAP, United Nations Building
Rajadamnern Nok Avenue
Bangkok 10200, THAILAND

QUESTIONNAIRE

	Excellent	*Very good*	*Average*	*Poor*
1. Please indicate your assessment of the *quality* of the publication on:				
• Presentation/format	4	3	2	1
• Readability	4	3	2	1
• Timeliness of information	4	3	2	1
• Coverage of subject matter	4	3	2	1
• Analytical rigour	4	3	2	1
• Overall quality	4	3	2	1
2. How *useful* is the publication for your work?				
• Provision of information	4	3	2	1
• Clarification of issues	4	3	2	1
• Its findings	4	3	2	1
• Policy suggestions	4	3	2	1
• Overall usefulness	4	3	2	1

---

3. Please give examples of how this publication has contributed to your work:

....
....
....
....

4. Suggestions for improving the publication:

....
....
....
....

5. **Your background information, please:**

Name: ....

Title/position: ....

Institution:..

Office address: ....

....

....

Please use additional sheets of paper, if required, to answer the questions.
Thank you for your kind cooperation in completing this questionnaire.

United Nations publications may be obtained from bookstores and distributors throughout the world. Please consult your bookstore or write to any of the following:

Customers in: America, Asia and the Pacific

Email: order@un.org
Web: un.org/publications
Tel: +1 703 661 1571
Fax: +1 703 996 1010

Mail Orders to:
United Nations Publications
PO Box 960
Herndon, Virginia 20172
United States of America

Customers in: Europe, Africa and the Middle East

United Nations Publication
c/o Eurospan Group
Email: info@eurospangroup.com
Web: un.org/publications
Tel: +44 (0) 1767 604972
Fax: +44 (0) 1767 601640

Mail Orders to:
United Nations Publications
Pegasus Drive, Stratton Business Park
Biggleswade, Bedfordshire SG18 8TQ
United Kingdom

For further information on this publication, please address your enquiries to:

Chief
Conference and Documentation Services Section
Office of the Executive Secretary
Economic and Social Commission for Asia and the Pacific (ESCAP)
United Nations Building, Rajadamnern Nok Avenue
Bangkok 10200, Thailand

Tel: 66 2 288-1110
Fax: 66 2 288-3018
E-mail: escap-cdss@un.org