# EXECUTIVE SUMMARY

## Sustaining a nascent recovery

After the pandemic-induced economic contraction in 2020, economic recovery in the developing Asia-Pacific counties in 2021 was driven by robust demand for exports from the region. The growth momentum was dented towards the latter half of the year as countries renewed lockdowns and restrictions in the wake of new COVID-19 variants, leading to supply disruptions. Border openings were further delayed, holding back employment recovery, particularly in tourism-dependent economies. Overall, economic growth in developing countries in Asia and the Pacific, estimated at 7.1 per cent in 2021, is projected to moderate to 4.5 per cent in 2022 and 5 per cent in 2023. Inflation has risen across the region, driven by rising food and fuel prices, affecting the poor disproportionately. Importantly, the unfolding of a K-shaped recovery among different sectors represents a major challenge for inclusive recovery and development, and is likely to further impede progress towards implementation of the 2030 Agenda for Sustainable Development.

In addition, policymakers need to be aware of impending risks, including the possible emergence of new variants of the COVID-19 coronavirus and the ongoing geopolitical conflict. Continued economic disruptions can have adverse impacts on productive capacities and long-term productivity through shorter working hours and lack of employment opportunities, which would erode worker skills. Within the region, women have been disproportionately affected by the pandemic as a large proportion of them were employed in sectors most severely affected by the pandemic and a large proportion of them are engaged in informal employment. Women's labour force participation has also been constrained by care responsibilities during closure of schools and care services. Prolonged school closures have long-term consequences for learning and, consequently, income-earning potential. Weakened economic prospects and balance sheets of businesses are likely to reduce incentives for productive investment and in research and development, resulting in medium- to long-term reductions in productivity.

Moreover, the diminishing fiscal space in many countries casts doubts over sustained fiscal support, while rising inflationary pressures and the prospect of higher interest rates may restrain monetary policy support, with implications for debt servicing, capital flows and currency depreciation. The structural shifts in China as it pursues its "Common Prosperity" agenda have triggered regulatory changes weighing on investor sentiment. Of particular importance are regulations to contain the highly leveraged property development sector, the slowdown in which will affect key trading partners and the demand for raw materials in the region. China's zero-COVID strategy will also have impacts on countries in the region that are highly dependent on tourist arrivals from China.

In looking ahead, the region should seek a balanced approach to coexist with the pandemic – one which is aimed at protecting public health but also enabling livelihoods to continue in order to ensure the economic and social well-being of people. For a sustained recovery, labour market policies, along with continuity in fiscal and monetary support, are needed. However, in the midst of constrained fiscal space, fiscal spending will have to be more targeted and efficient. With rising inflationary pressures, monetary policy can remain accommodative only in countries where inflation is expected to remain within targets, while timely increases in interest rates can help stem potential capital outflows and strengthen external position. Policies that are aimed at enhancing productive capacities and productivity, along with prioritizing spending on health care, education and social protection, can help to reduce inequalities and minimize scarring, thus contributing to sustained and inclusive economic recovery and development.

# Spending smart and taxing fairly amid fiscal constraints

The COVID-19 pandemic and the consequent economic crisis pose a fiscal dilemma for countries in the Asia-Pacific region. The need to spend remains elevated, while the means to spend are reduced. Countries with sufficient fiscal space can continue to spend for an inclusive recovery. However, those that do not have the means will have to work on both improving the efficiency of spending and the collection of more revenues.

To ensure recovery at all income levels, instead of a K-shaped scenario, and lay firmer foundations for a more equal and resilient future, fiscal policies need to maintain spending in three major areas: health care, education and social protection. Moreover, Governments should "spend smart" by reducing or eliminating inefficiencies in expenditures and ensuring that basic health care services become increasingly universal, that all children receive high-quality education, especially girls and those in rural areas, and that social protection measures shield all throughout their life, in particular marginalized and vulnerable groups. These expenditures will not only minimize the negative long-term effects of the pandemic but will also help generate long-lasting returns. After all, expenditure on human capital is the best investment for our future.

However, "smart spending" will not be enough to address all the fiscal needs for "building forward fairer" towards achieving the Sustainable Development Goals of the 2030 Agenda. Support must come from the fiscal revenue side as well. "Taxing fairly", along with increases in tax collection efficiency and broadening of the tax base, should be the leading principles. In addition, there is a need to improve progressivity of personal income taxes, address persistent tax avoidance and evasion, close loopholes and cut unnecessary tax incentives. Improved multilateral cooperation for effective international taxation and for taxation of the emerging digital economy can go a long way in raising tax revenues of developing countries. Increases in domestic revenues through formalization of economic activities also provide an opportunity not only to increase fiscal revenues but also to expand critically needed social protection measures and access to universal health care.

Calls for implementation of the above-mentioned measures and significant systemic changes have been raised multiple times; however, they have been delayed not only because of lack of resources, but also lack of commitment, as well as administrative and operational barriers. As the pandemic has encouraged and facilitated innovation across all socioeconomic dimensions, the global transition towards digitalization should be of particular interest to policymakers in the coming years. For example, deployment of digital tools for fiscal management enhances expenditure control and results in much needed savings and efficiency gains. In supporting formalization of economic activities, new technologies generate further positive implications for accessibility of government services and revenue collection, ensuring that all contribute their fair share but also receive the support, as well as public goods and services, to which they are entitled.

# Conducting central banking for a fairer future

The perceived failure of the "developmental" central banking approach, which was pursued until the 1980s and benefited only a few economic sectors, led central banks in developing countries to focus narrowly on achieving inflation stability. The ***Survey*** for 2022 argues that Asia-Pacific central banks can and should play an important, complementary role in promoting inclusive development.

Asia-Pacific central banks should step up their engagement with inclusive development amid mounting fiscal constraints to tackle pandemic-induced rises in inequality. Currently, only half of central banks in the region have taken up inclusive finance concerns, which is a missed opportunity given that financial access, financial education and consumer protection benefit the poor relatively more than the better off. Even when central banks have no clear mandate for inclusive finance or a development agenda, they should be concerned about high inequality because this undermines the effectiveness of their monetary policy.

The good news is that central banks in the region can support inclusive development through various policy strategies and tools. The ***Survey*** for 2022 examines how the central bank roles of monetary policymaking, official reserve management, currency issuance and financial sector regulation can promote more inclusive societies.

While monetary policy has indirectly helped the poor by striving to keep inflation low and stable, central banks can also consider the impact of monetary policy on income and wealth distribution, even raising ambitions to make economic equality a secondary goal and allocating part of asset purchases to domestic social bonds. Several Asia-Pacific central banks would likely achieve their core mandate of inflation stability in the coming years, so the pursuit of inequality-mindful monetary policy is possible.

The bulk of the estimated $9.1 trillion in Asia-Pacific official reserves is invested in bank deposits and money market instruments which offer no clear or direct social benefits. Changes in investment strategies and internal governance on investment decisions can mobilize more official reserves for social purposes. More ambitious central banks can deploy part of excess reserves as seed capital for local social projects. As official reserves are deemed more than adequate in several Asia-Pacific economies, there is room for more socially oriented reserve management.

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

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

## Managing structural changes for a fairer future

While redistributive policies play a role in inclusive development, evidence shows that pre-distributive policies – meaning those that take place before taxes and transfers – are even more important. Structural transformation provides a unique lens for analysing pre-distribution dynamics over time.

The Asia-Pacific development experience to date suggests that pre-distribution dynamics driven by structural transformation are diverse, but inclusive economic development paths are still possible. The Kuznets' tension – the tendency of increasing inequality at an early stage of structural transformation – can be eased with faster job creation through labour-intensive manufacturing development, more inclusive access to public goods and services, rapid increases in skill supply through education and greater equity at the start of economic take-offs. On the other hand, pre-existing inequalities, the shift towards service-based economies and structural bottlenecks may lead to greater inequality pressures even in the presence of economic growth.

New technological revolutions may lead to paradigm shifts in structural transformation possibilities and modalities, with mixed implications for inequality. The combined effect of automation and industrial reshoring may limit the space for labour-intensive manufacturing and modern services, resulting in risks of slower job creation and polarization, and therefore, higher inequality. While the greater offshoring potential of services, enabled by the digital and robotic transformation, may create new job opportunities for low-income labour in developing countries in value chains for services, significant uncertainties in the direction, scale and speed of these transformations remain. It would thus be important for Asia-Pacific developing countries to adopt a balanced development strategy embracing both manufacturing and modern services for poverty reduction and to remain vigilant and be prepared for potential disruptions.

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