

The background is a complex, layered composition. At the top, there's a dark blue area with white line graphs showing fluctuating trends. Below this, a greenish-blue section features a bar chart with several vertical bars of varying heights. The bottom portion of the image is dominated by a dark blue area with a grid of small, glowing white squares, resembling a digital or data matrix. Overlaid on these elements are faint, semi-transparent text fragments, including numbers like '+0.95' and '+1.00'.

CHAPTER

01

ECONOMIC OUTLOOK AND QUALITY OF GROWTH

1. INTRODUCTION

The Asia-Pacific region's high and steady economic growth has served as an anchor of stability in recent years for the struggling global economy. In considering its high openness to trade, the region's relative resilience to weak external demand may come as a surprise. One explanation is the increased size of domestic and regional demand. The region's developing economies now account for a third of the world's output, only slightly less than the combined share of the developed economies in North America and Europe. If the region continues to outpace global economic growth at the current pace, it would account for more than half of global output by 2050. The region's income level would converge towards the global average and make the region home to the majority of the global middle class. The Asia-Pacific region's prominence is also likely to increase in such areas as global trade, finance, technology and education such that what the region does will affect the rest of the world compared with the past when the region was primarily affected by external developments.

For the Asia-Pacific region to realize its full potential, however, it cannot rely simply on past strategies and patterns of economic growth. For future growth, the region will need to rely more on broad-based productivity gains, which in turn will require effective institutions and governance in both the public and the private spheres. In the developing Asia-Pacific region, growth in overall labour productivity has declined by a third in the period following the financial and economic crisis that started in 2008 even as wide productivity gaps remain across and within sectors, particularly in agriculture and among small firms (ESCAP, 2016c). Public investments in such areas as health, education, training and infrastructure also need to be increased. Not surprisingly, the importance of a pro-active fiscal policy is emphasized in the section on policy considerations, along with a discussion on fiscal space. Additionally, a better policy and regulatory environment could make markets function well and stimulate productivity-enhancing innovation and private investment. Such efforts are particularly important given the increasingly uncertain global environment, especially for trade, as highlighted in the economic performance outlook section.

Another reason why the Asia-Pacific region cannot simply replicate its past economic growth patterns is the rising social and environmental pressures. Decades of rapid economic growth, facilitated by globalization and technology, came at a cost – rising inequalities and environmental degradation. The share of wages in national income declined in many countries even as

wage inequalities widened. Owing to skills mismatches and lack of social protection, many were left behind in the creative destruction of jobs. While many have been lifted out of extreme poverty, the majority of the region's population are not yet “middle class” but could rather be classified as “transitional class” that is vulnerable to falling back into poverty (ESCAP, 2016c). This is why one of the selected topics in the quality of growth section is social protection. At the same time, the Asia-Pacific region is highly vulnerable to climate change, the adverse effects of which can substantially undermine the economic development gains in the region. Clean air, safe drinking water, sufficient food and secure shelter – key determinants of health – are also adversely affected. Internalizing the costs of environmental degradation will thus be important, as is argued in the quality of growth section.

It is in such a context of productivity-enhancing reforms and social and environmental measures that better and more effective governance becomes important. The governance theme is explored in depth in chapter 3, while subregional and country-specific developments and challenges are discussed in chapter 2. What is done in chapter 1 is to present a regional macroeconomic assessment in view of the 2030 Agenda for Sustainable Development.¹ The chapter consists of three sections. The first section on economic performance and outlook provides an assessment on consumption and investment patterns, external sector developments and major risks to the outlook for economic growth. In the second section on economic policy considerations, stock is taken of recent monetary, fiscal and structural policies, and issues that require attention are highlighted. In the third section on the quality of growth a number of issues are addressed concerning labour markets, income distribution, social protection and environmental sustainability.

2. ECONOMIC PERFORMANCE AND OUTLOOK

2.1. Asia-Pacific economies lead global growth but at less rapid pace

Following a strong post-crisis rebound in 2010, economic growth in the Asia-Pacific region has been moderate in recent years compared with its historical trend. The region's export-oriented economic growth strategy is under pressure amid prolonged weakness in external demand and global trade. China is both a transmitter and a source of the current economic slowdown, given its role as a hub in global value chains and its rebalancing towards consumption and services. The recent

slowdown is also due to large terms of trade losses among net commodity exporters, such as the Russian Federation. Fortunately, both China and net commodity exporters had sufficient fiscal space to respond to such shocks. In particular, China's fiscal stance has been very expansionary, with large budgetary and non-budgetary support provided for the economy. India also regained its economic growth momentum on the back of reform initiatives and the beneficial impacts of low global oil prices. Taken together, the Asia-Pacific region's economic performance, although modest compared with its recent past, is commendable when viewed against the backdrop of a struggling global economy.

As noted in the Introduction, the region's developing economies now account for a third of global output, only slightly less than the combined share of developed economies in North America and Europe (see figure 1.1). This convergence is likely to continue in the coming years, despite a narrowing growth differential between developing Asia-Pacific economies and the developed global economies.

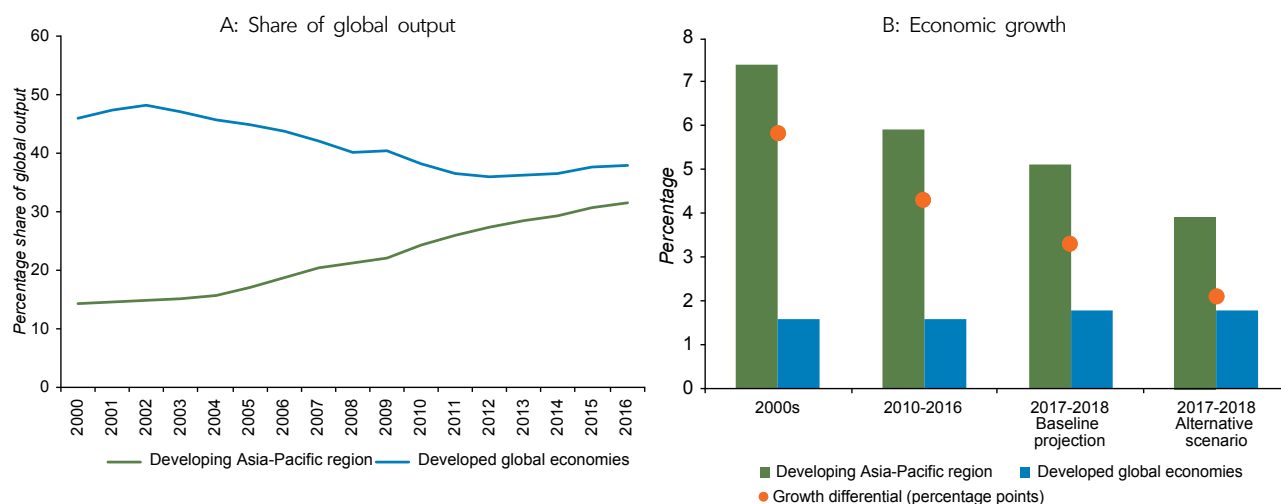
In 2016, economic conditions in the region began to stabilize, with better-than-expected performance exhibited by China and a recovery under way in net commodity-exporting countries. However, growth slowed considerably in Turkey due to the political situation and to a lesser extent in India due to the impacts of demonetization (see box 1.1).² Taken together, average economic growth in developing Asia-Pacific economies is estimated to have been 4.9 per cent in 2016, largely stable compared with that of the previous year, without a further deceleration.

2.2. Private investment has not been forthcoming

Across the region, economic growth in recent years has relied more on domestic demand (defined as GDP excluding net exports) given the prolonged weakness in external demand and global trade (see figure 1.2). In particular, in line with the region's growing purchasing power, domestic private consumption has been the major driver of growth. In China, the contribution of consumption to overall growth edged up, indicating progress in the rebalancing of the economy. In India, rural consumption was helped by a better monsoon season following two years of poor monsoon rain. In the Republic of Korea and Thailand, where high household debt has weighed on consumer spending, some boost was provided by fiscal stimulus measures. In the Russian Federation, there was a milder contraction in consumption compared with the previous year as inflation subsided.

The relatively strong performance in consumption may come as a surprise, given that exports and investment have been relatively sluggish in recent years, resulting in low capacity utilization, underemployment and weak nominal wage growth.³ Potential explanations include real wage growth from low inflation, ease of borrowing as a result of low interest rates and spending by the rich who benefited from the increased value of their assets. These factors, however, would not support a durable expansion of domestic demand. First, inflation is likely to pick up in most countries in line with the partial recovery in global oil prices; in any case, wage growth would ultimately depend on productivity growth and labour market institutions – areas which require greater

Figure 1.1. Economic growth in Asia-Pacific region and the world



Source: ESCAP, based on table 1.1 and box 1.4 and data from IMF, World Economic Outlook Database. Available from www.imf.org/external/pubs/ft/weo/2016/02/weodata/index.aspx (accessed 1 February 2017).

Note: The term developed global economies refers to Canada, United States and Western Europe.

Box 1.1. Potential impact of demonetization in India

On 8 November 2016, India's Prime Minister announced that the Reserve Bank of India would withdraw India's two largest currency denominations, Rs 500 and Rs 1,000, from circulation. The two banknote denominations withdrawn represented more than 86 per cent of the cash in circulation. This policy initiative was aimed at (a) tackling the supply of high-denomination counterfeit notes, which were being used for financing terrorism, among other things, and (b) drawing out the storage of unaccounted wealth, the latter being known as "black money", undeclared to tax authorities.^a

Preliminary GDP estimates showed that the economy expanded by 7 per cent from October to December 2016, slowing only marginally from 7.4 per cent in the preceding quarter. However, as also noted in the Government's *Economic Survey*, official figures could overstate economic growth as the large and cash-intensive informal sector is not adequately captured by the statistics, surveys and corporate financial statements on which the national accounts calculations are based. For instance, strong private consumption figures may be the result of Indians adopting Internet-based payment systems, leading therefore to an increase in activity in the formal sector. At the same time, the turnaround in investment, from contraction to growth, was less surprising, as base effects no longer acted as a drag on growth. It is conceivable, however, that the numbers for the official national accounts will be revised downward in the future.

The disruption had greater and longer-lasting impacts for lower-income individuals, households and businesses that had difficulty insulating themselves against the shock. Rural incomes and consumption were affected due to a decline in prices for agricultural products (although again, this was not reflected in the national accounts data which measure agriculture in terms of quantity). To mitigate the short-term negative impacts of the policy initiative, the Prime Minister announced in December 2016 measures to support the informal sector affected by demonetization, including furnishing higher credit limits for small enterprises, writing off interest on certain loans for farmers and instituting interest rate subvention on loans for low-income housing schemes.

In the medium-term, the currency initiative is expected to bring more economic activities into the formal sector and spur digitization of financial transactions, helping to broaden the tax base and secure the fiscal space needed for public social and infrastructure expenditures. In India, there were only 33.1 million effective taxpayers in 2014/15 for a population of more than 1.2 billion people.^b The one-off currency measure in effect transferred lost black money to the Government through unclaimed or unexchanged notes. Preliminary estimates suggested a 97 per cent recovery of notes, which would imply a 3.16 per cent increase in fiscal revenues for the Government.

The measure did not, by itself, impede future black money flows in new denominations. While estimates of the size of the black economy vary at about 20-25 per cent of GDP, cash is estimated to make up only about 10 per cent of that value.^c Thus, complementary measures would be required to target all forms of undeclared wealth and assets. Broader structural reforms which could also contribute to enhanced transparency include: the implementation of a goods and services tax; voluntary disclosure of income scheme; and tracking of high-value transactions through taxpayer identification numbers. Other measures, such as reforming the real estate registration process to ensure transparency, are being discussed.^d

A more permanent increase in digital-enabled and non-cash-based transactions is likely, driven by awareness of cash-alternative solutions during the demonetization exercise and strong government advocacy and incentives. Digital payments are not a daily tool of most people in India, accounting for only 20 per cent of total transactions and 5 per cent of personal consumption expenditure.^e Moving towards a cashless economy will require addressing household determinants of cash dependence beyond technology adoption, including low financial inclusion, high informality, persistent gender inequality in access to finance, low financial literacy, low ICT infrastructure and large gaps in energy access.

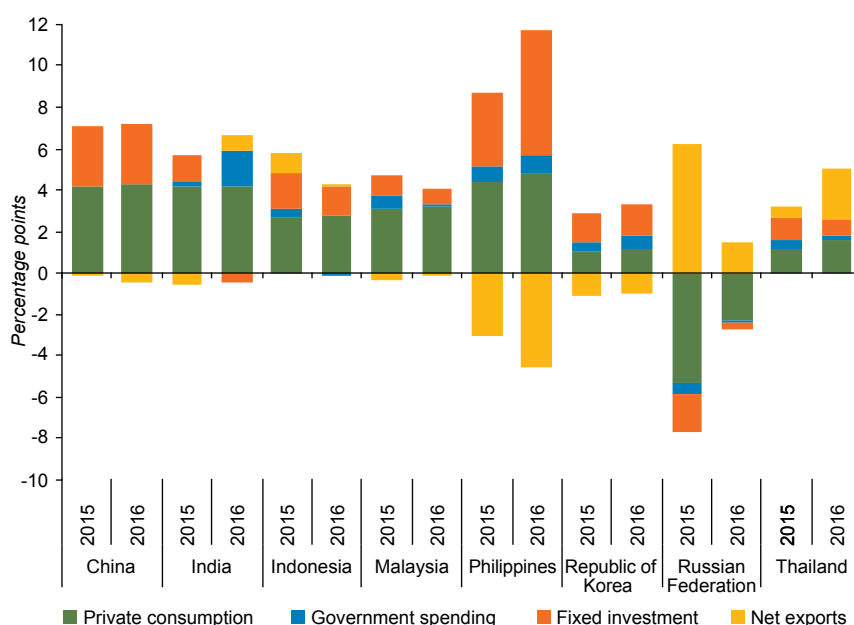
^a *Gazette of India*, 8 November 2016, No. 2652 (<http://finmin.nic.in/172521.pdf>), and Reserve Bank of India, Press Release, 8 November 2016 (www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=38520).

^b See India, *Economic Survey*, 2015-16, chap. 7. Available from <http://indiabudget.nic.in/es2015-16/echapvol1-07.pdf>.

^c The World Bank in 2010 estimated the size of the shadow economy for India at 20.7 per cent of GDP in 1999 and rising to 23.2 per cent in 2007. Bank of America-Merrill Lynch estimated the black economy at 25 per cent of GDP and the cash-based black economy component being approximately 10 per cent of that proportion.

^d Statement by Executive Director for India on 25 January 2017 on the occasion of the IMF Article IV consultations.

^e India, Ministry of Finance. Medium term recommendations to strengthen digital payments ecosystem. Report of the Committee on Digital Payments. Available from http://finmin.nic.in/reports/watal_report271216.pdf.

Figure 1.2. Demand-side contributions to economic growth in selected countries

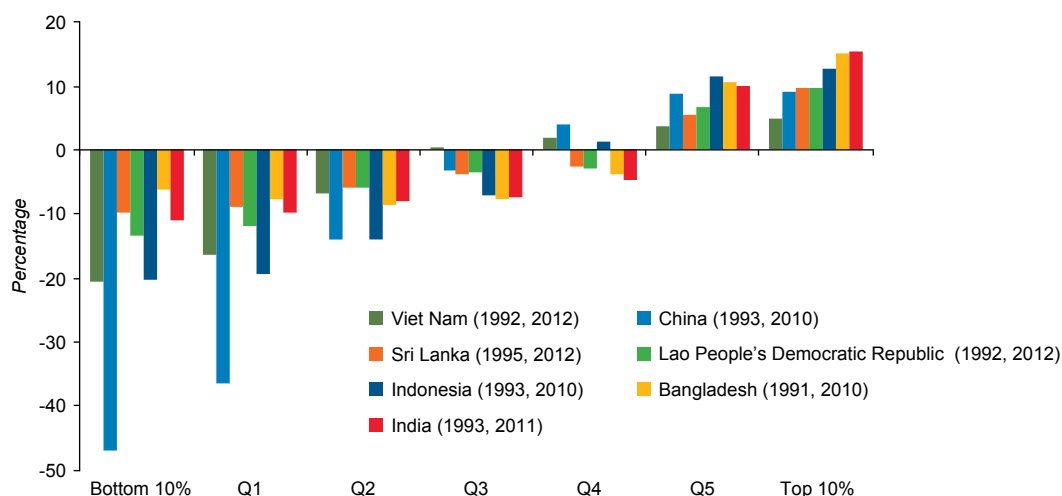
Source: ESCAP, based on data from CEIC.

Note: Total consumption and gross capital formation for China; fiscal year for India (April-March); 2016 data for India includes the first three quarters of fiscal year.

policy attention. Second, households could benefit from borrowing (for instance, to smooth consumption), but unlike income, borrowing has to be paid back, and this burden could become too heavy, especially if earnings are not strong. Third, strong growth in real estate and equity values were partly driven by favourable liquidity conditions, which are likely to tighten in the near future. Moreover, excess inequality in consumption, as reflected in strong sales of luxury goods even during recessions, is not desirable for a society. Thus, beyond the aggregate

consumption figures, attention also needs to be paid to the drivers and the distribution of consumption. Available data suggest that increases in consumption since the 1990s were not evenly distributed, with increases in the top quintile and decreases in the bottom three quintiles (see figure 1.3).

Investment performance was relatively weaker in most countries, despite low interest rates. Its contribution to overall growth was relatively modest in Indonesia, Malaysia

Figure 1.3. Change in consumption share since the 1990s

Source: ESCAP, based on World Bank, World Development Indicators.

Note: "Q" means quintile, with Q5 indicating the top 20 per cent of households in terms of consumption.

and Thailand and negative in India (see figure 1.2). This outcome was despite a significant reduction in policy interest rates in India and Indonesia and an increase in tax incentives in Thailand. In countries such as Thailand, weak private investment was partly offset by strong public investment, whereas in India and Indonesia weaker-than-expected public investment further weighed on private investment. Bucking the trend was the Philippines, where robust private investment complemented traditionally strong consumption as another engine of growth.

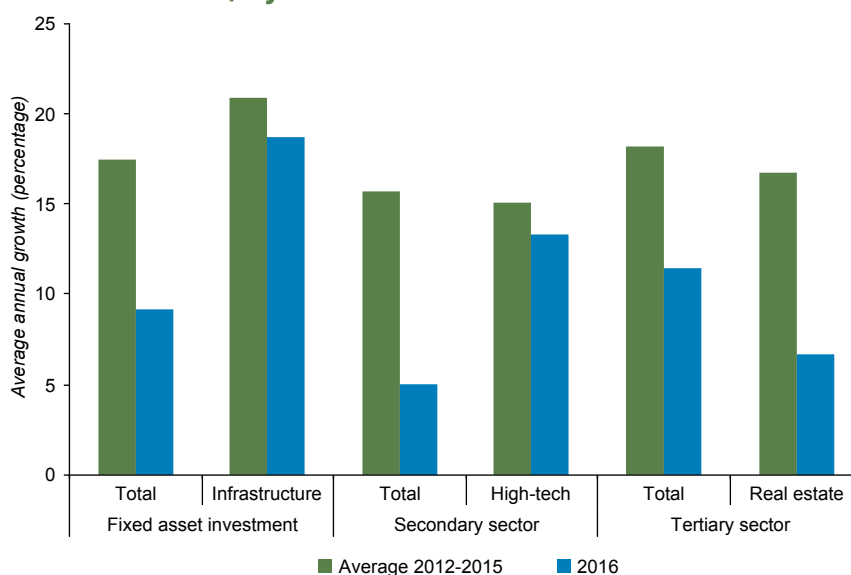
In China, investment growth was relatively stable in 2016 due in part to large public infrastructure outlays which stimulated the construction sector. Infrastructure investment grew by nearly 20 per cent, or about double the pace of overall fixed asset investment (see figure 1.4). This development coincided with some bottoming out in private investment, which had been steadily moderating in recent years. In particular, investment in the high-technology manufacturing sector grew at a relatively healthy pace. This was in line with the Government's policy to foster innovation-led growth and support higher value-added sectors.

While large public outlays were able to offset the slowdown in private investment in China, this was not the case in most countries. Even in China, growth in private investment in recent years was much lower compared with the pre-crisis period (see figure 1.5).⁴ Weak private investment is explained in part by global factors, such as overall weak aggregate demand and

heightened uncertainty (see figure 1.6). For instance, global growth forecasts have been constantly revised downward in recent years, lowering the expected returns for business. A related factor was excess capacity and low capacity utilization in certain industrial sectors, as reflected in subdued industrial production. There were also signs of debt overhang and balance sheet pressures in the corporate and banking sectors in some of the major economies, including China and India (ESCAP, 2016c).

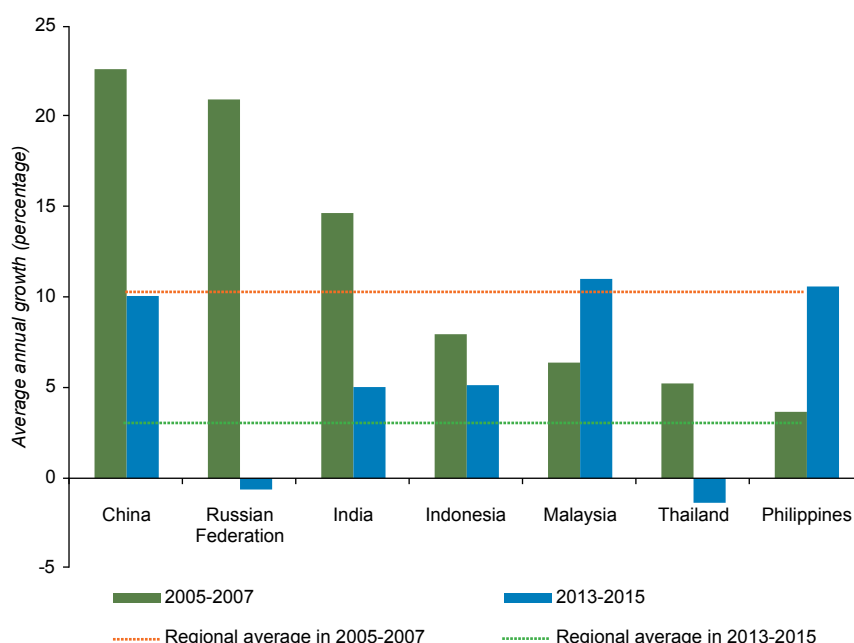
Without robust private investment, however, a durable recovery will not be possible. Countries such as the Republic of Korea, which have sustained high economic growth for an extended period, managed to also sustain high investment growth for an extended period. Aside from increasing investment, enhancing the quality of growth and allocating resources to productive sectors will be important to enhance the return on investment and avoid "boom-bust" cycles. Although global factors may be difficult to address, countries could ease domestic constraints to private investment. In China, a priority is to address excess capacity in certain sectors, facilitate deleveraging and create a level playing field between State-owned enterprises and private firms. In India, a priority is to repair bank balance sheets, especially those of public sector banks. For all countries, in the medium term, increasing infrastructure investment and enhancing the business environment could stimulate private investment. However, least developed countries face various challenges in this regard (see box 1.2).

Figure 1.4. Investment in China, by sector



Source: ESCAP, based on data from CIEC and China National Bureau of Statistics.

Note: The data presented is the average annual growth rate in 2012-2015 and 2016. Fixed asset investment (FAI) includes capital spent on infrastructure, property, machinery and other physical assets. High-technology industry is defined as FAI in manufacturing of computers, communications and other electronic equipment.

Figure 1.5. Private investment

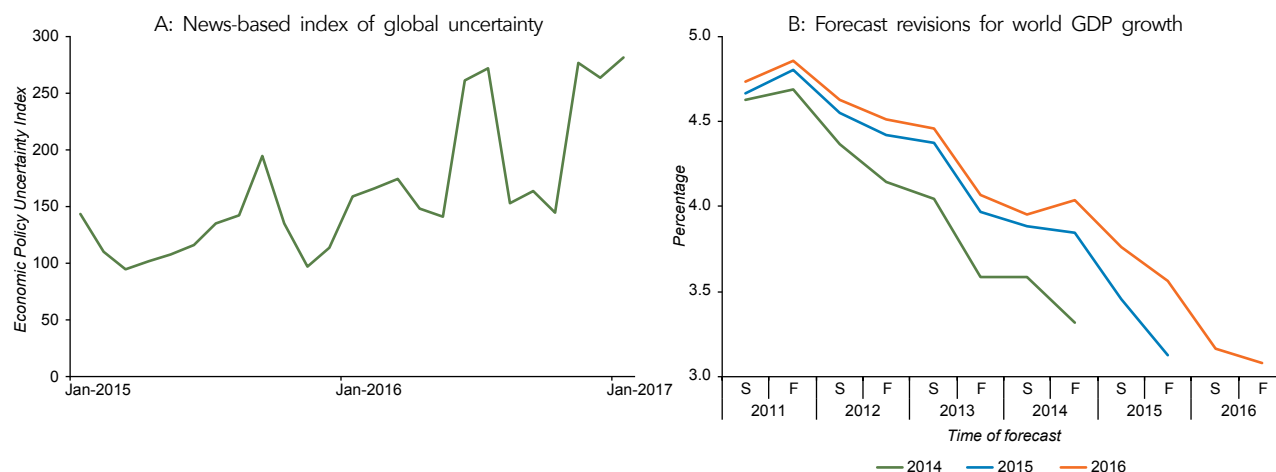
Source: ESCAP, based on IMF, Investment and Capital Stock Dataset. Available from www.imf.org/external/np/fad/publicinvestment/ (accessed 1 February 2017).

Note: The data presented are the average annual growth rate in 2005-2007 and 2013-2015, in constant 2011 international dollars. As shown in the dotted lines, the median value of private investment in 33 regional economies declined from 10.3 per cent in the period 2005-2007 to 3 per cent in the period 2013-2015.

2.3. Weak trade and volatile capital flows present a tough external environment

Exports have been weighed down in recent years by both cyclical and structural factors (ESCAP, 2016b). Nominal growth of exports was particularly weak in 2015 owing to lower global oil prices, which in turn affected domestic producer prices. A partial recovery was under way in 2016, but export growth was still weak by the

end of the year and far below the recent historical trend in most countries (see figure 1.7). Imports, which had also contracted through the first half of 2016, began to return to positive growth in the second half of 2016 in several countries, including China, India, Indonesia, the Russian Federation and Thailand. In such countries as India and Thailand, a large net positive contribution was more a reflection of weak domestic demand, particularly investment, rather than strong exports.

Figure 1.6. Indicators of uncertainty

Source: ESCAP, based on data from Baker, Bloom and Davis (2016) and IMF, *World Economic Outlook*, various issues.

Note: A: The higher the figure, the greater is the uncertainty. B: Forecasts made in the Spring (S) and Fall (F) issues of the IMF *World Economic Outlook*.

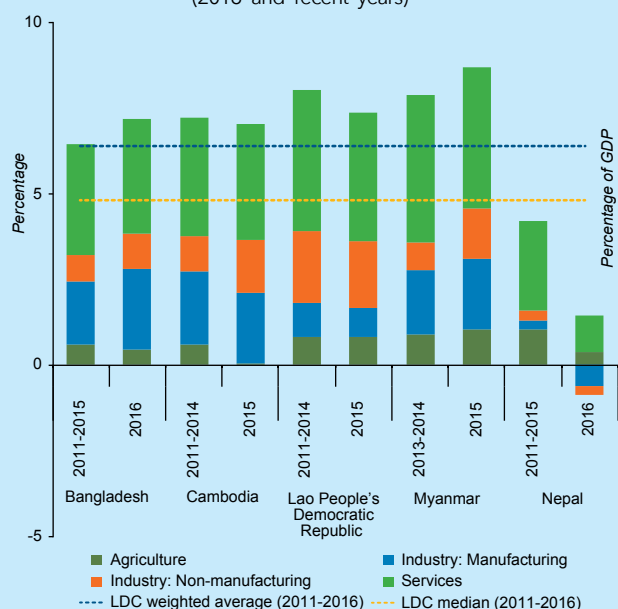
Box 1.2. Growth and investment in least developed countries

Average economic growth in the region's least developed countries was estimated to be 6 per cent in 2016. In particular, Bangladesh, Cambodia and Myanmar have benefited from increased inflows of foreign direct investment (FDI) in recent years, partly due to relocation of production from China. The inflows have supported relatively strong manufacturing growth in these economies (see figure A). However, only a few least developed countries have achieved the 7 per cent growth target envisioned in the Programme of Action for the Least Developed Countries for the Decade 2011-2020^a (Istanbul Programme of Action). Median economic growth among the region's least developed countries has been below 5 per cent in recent years, or below the average for the developing countries in the Asia-Pacific region due in part to the impact of economic and non-economic shocks, such as natural disasters. Pacific least developed countries, such as Tuvalu and Vanuatu, had the lowest growth rates.

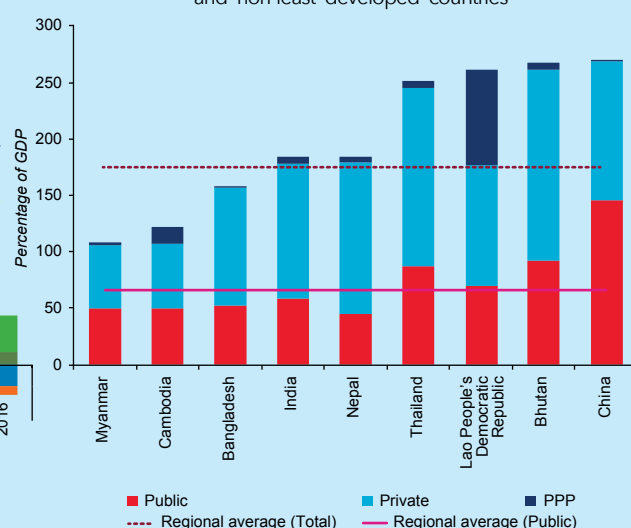
The slow growth in the region's least developed countries is partly due to severe deficits in physical infrastructure. This is also reflected in their relatively low capital stocks, with exceptions, such as Bhutan and the Lao People's Democratic Republic, due to their hydropower sectors (see figure B). In ESCAP (2017) it was suggested that providing transport infrastructure and energy is particularly important to the least developed countries. More sustainable, inclusive and reliable energy, especially solar and hydropower, would enable these countries to accelerate the process of expanding their productive capacities and increase their levels of productivity, while bridging transport infrastructure gaps would be important to improve access to domestic and international markets. Doing so would translate into higher wages and contribute to reducing poverty. This situation also points to the need to strengthen ICT infrastructure in Pacific least developed countries.

Nevertheless, least developed countries are facing major challenges in raising sufficient resources. Those with a small private sector and underdeveloped capital market will need to rely on limited domestic public finance and on official development assistance. New financing vehicles, including cooperation arrangements and public-private partnerships, could offer potential sources of infrastructure financing, but only after institutional capacities have been strengthened. Furthermore, those economies in the Pacific face high costs of developing infrastructure, particularly given their geographic isolation. They also face the additional challenge of having to maintain the steady erosion of infrastructure due to the impacts of climate change.

A: Supply-side contributions to real GDP growth (2016 and recent years)



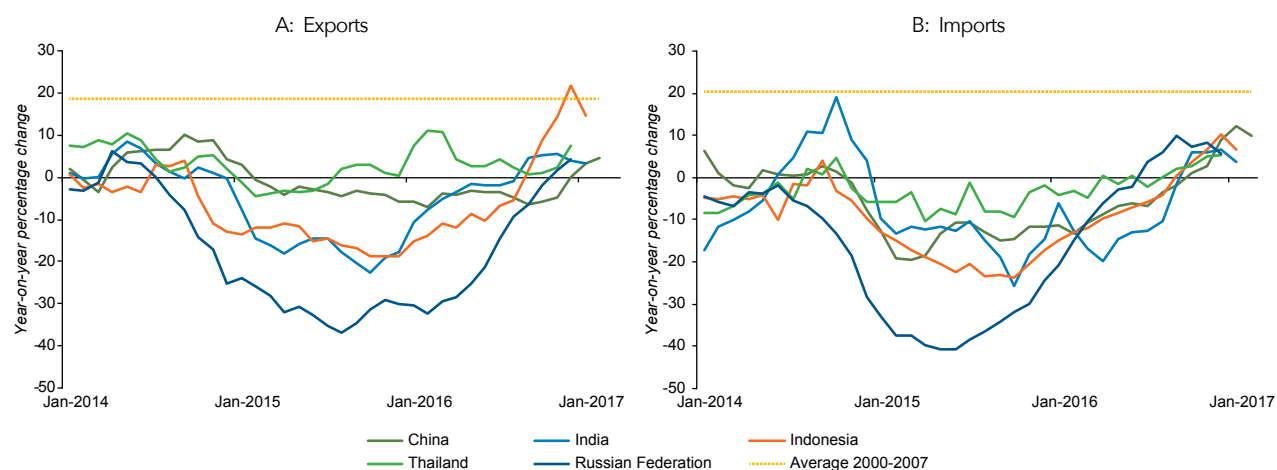
B: Estimated capital stocks in selected least developed countries and non-least developed countries



Source: ESCAP, based on data from CEIC and IMF, Investment and Capital Stock Dataset. Available from www.imf.org/external/np/fad/publicinvestment/ (accessed 1 February 2017).

Note: A: The weighted average and median real GDP growth rates are based on all 12 regional least developed countries, but supply-side contributions are presented for selected least developed countries, for which data are available. B: Estimated stocks in 2015 based on constant 2011 international dollars. PPP refers to public-private partnership. Regional average of 33 economies.

^a General Assembly resolution 65/280.

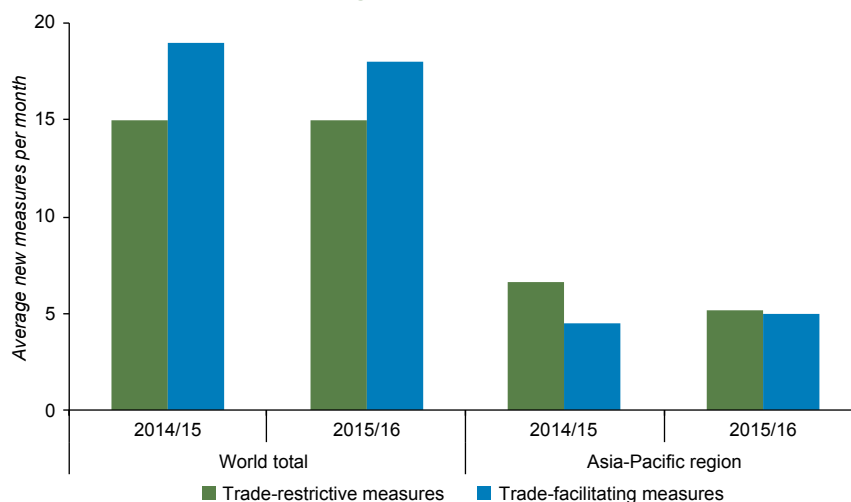
Figure 1.7. Nominal growth in trade

Source: ESCAP, based on data from CEIC and ESCAP Statistical Database. Available from www.unescap.org/stat/data (accessed 1 February 2017).

Note: The dotted line indicates average annual growth rate for the period 2000-2007 in China, India, Indonesia, the Russian Federation and Thailand.

Despite the recent mild recovery, exports are unlikely to be a major driver of economic growth for developing economies in the region, which is partly due to structural changes in global trade. Important factors include changes in demand structure, the deceleration in the expansion of global value chains and the impact of China's economic transformation (see box 1.3). The ratio of growth in trade volume and global GDP has noticeably declined in recent years, falling below 1 in 2016. The exchange rate elasticity of exports also seems to have declined. The intensification of global supply chains has slowed significantly since 2009, implying that trade volumes and global production could become

increasingly disconnected from one another (ESCAP, 2015a; Hoekman, 2015). Given such changes, the degree to which a pickup in global output or depreciation of regional currencies would translate into higher export volumes is uncertain. Rising protectionist measures and sentiments are also adding to the current uncertainty. The stockpile of trade-restrictive measures has increased in recent years, both globally and in the region (see figure 1.8). The initiation of trade remedy measures relating to anti-dumping, countervailing duties and safeguards has also dramatically increased (ESCAP, 2016b), affecting progress of trade liberalization, including through preferential trade agreement efforts.

Figure 1.8. Trade-restrictive and facilitating measures

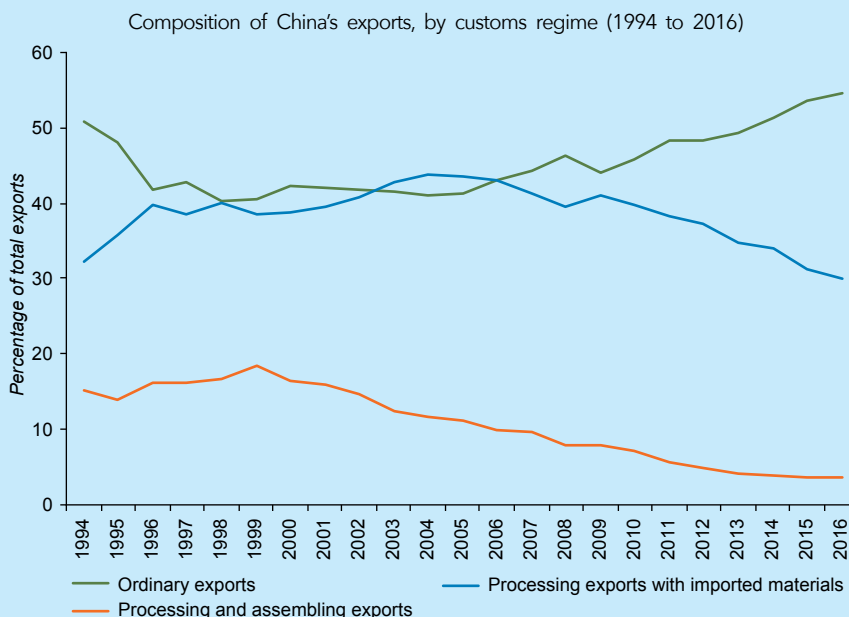
Source: ESCAP, based on data from World Trade Organization, Trade Monitoring Reports, several issues. Available from www.wto.org/english/tratop_e/tptr_e/trade_monitoring_e.htm; and ESCAP, *Asia-Pacific Trade and Investment Report 2016: Recent Trends and Developments* (Sales No. E.16.II.F.23). Available from www.unescap.org/resources/asia-pacific-trade-and-investment-report-2016-recent-trends-and-developments.

Note: The years 2014/15 and 2015/16 refer to the period from mid-October of one year to mid-October in the next year.

Box 1.3. Structural changes in China's trade

China has gradually shifted from exporting consumer goods to capital goods. In addition, the country has decreased its reliance on imported inputs for export production and reduced its dependency on processing exports. The share of capital goods in China's total exports rose from 30 per cent in 2000 to nearly 50 per cent in 2008, while its share in total imports was declining. Intermediate imports were also declining, from 40 per cent of total imports to only 20 per cent during those years. The growth rate of processing exports has been lagging behind ordinary exports since 2005. As a result, the share of processing exports with imported materials decreased from 44 per cent of total exports in 2005 to less than 30 per cent in 2016 while the share of ordinary exports increased from 41 to 55 per cent (see figure below).

These trends suggest two important structural changes in China: the movement away from processing exports into more complicated exported goods, and the movement away from using imported inputs to using domestic inputs. The potential impacts of these changes on other countries in the region are as follows. The upgrading may lead to higher competition between China and countries that export intermediates and capital goods in global value chains. The countries most affected may be those in the group of upper-middle-income countries, such as Malaysia and Thailand. On the other hand, lower-wage economies with appropriate infrastructure, such as Cambodia and Viet Nam, may have an opportunity to replace China in the low-value added segments of global value chains. However, uncertainties remain in the latter case, because the relocation of assembly plants from a high-wage coastal region to a low-wage inland region is also possible. Wage levels in the inland regions of China are still relatively low. The inland regions have already participated in domestic value chains. They have indirectly exported through firms in the coastal regions of China (Meng and others, 2012). Furthermore, they have advantages in terms of closer proximity to suppliers of parts and components (the upstream segments of global value chains) and to a large domestic market.

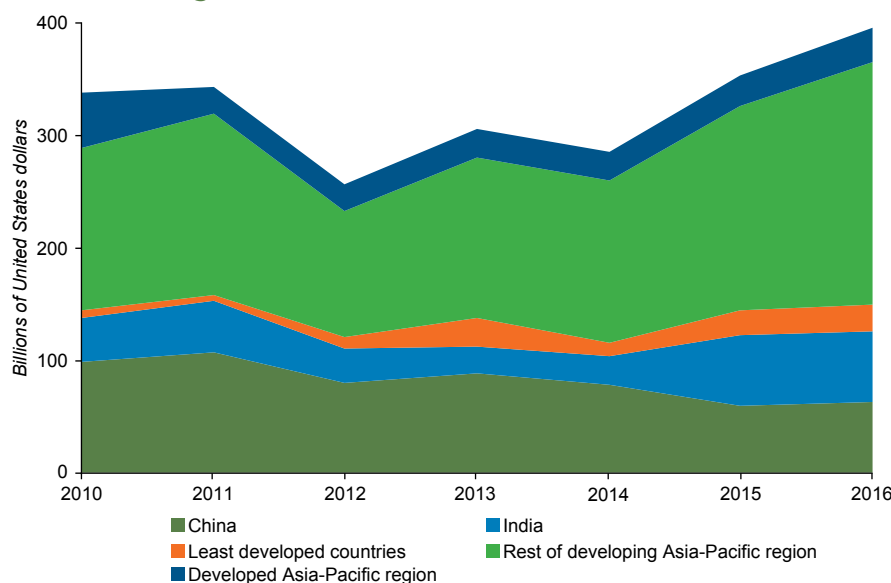


Source: ESCAP, based on data from CEIC.

On the FDI front, it is estimated that overall inflows to the region moderated in 2016 compared with that of the previous year, but remained high compared with the recent historical trend. The largest inflows were to China; Hong Kong, China; Singapore; and India, in that order (UNCTAD, 2017). In considering only greenfield FDI (excluding mergers and acquisitions), it is estimated that inflows to the region rose further in 2016 and that inflows to least developed countries remained relatively strong (see figure 1.9). The region's FDI outflows have

also steadily increased in recent years, largely because of China, which is a major contributor to intraregional FDI, including through the Belt and Road Initiative.

However, non-FDI capital flows, such as portfolio flows and cross-border bank loans, have been quite volatile, in part due to realignment of exchange rates. With the strengthening of the United States dollar, most regional currencies have been depreciating bilaterally. The depreciation of some regional currencies was particularly

Figure 1.9. Greenfield foreign direct investment inflows

Source: ESCAP, based on data from Financial Times Ltd, fDi Intelligence. Available from www.fdiintelligence.com/

Note: The term developed Asia-Pacific region refers to Australia, Japan and New Zealand.

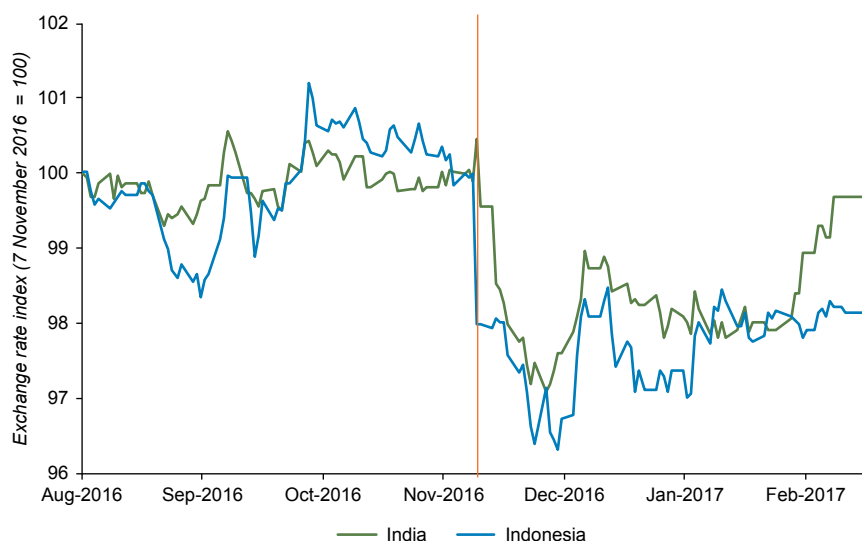
large in the wake of the United States presidential election in November 2016, although there has since been a partial recovery (see figure 1.10). Even before that election, the Chinese renminbi was under heavy depreciation pressure (see figure 1.11). China's foreign currency and bond markets went through substantial swings at the turn of the year. It is estimated that 40 per cent of the roughly \$490 billion in outflows in 2016 took place during the fourth quarter (BIS, 2017). With the introduction of new capital control measures in December, outflows slowed in the first month of 2017. Overall, the size of the bilateral trade surplus *vis-à-vis* the United States has been a relevant factor in explaining the different degree of improvement in exchange rates since the recovery, with the gains being relatively smaller in Asian economies compared with other regions.

A key question is whether depreciation of currencies will have a net positive impact, as some currency-induced export competitiveness may be offset by increased pressure on corporate balance sheets with high dollar debt. These in turn could affect domestic private investment in different ways. While exchange rate depreciation could potentially boost exports, this effect may be mitigated by trade protectionist measures. The elasticity of trade to exchange rate movements seems to have decreased in any case due to structural factors, such as the expansion of global value chains. On the other hand, the financial effect of exchange rate movements seems to have increased since the 2000s (Lane and Shambaugh, 2010). When banks and corporations have foreign currency liabilities, exchange rate depreciation

has valuation effects that can lead to a tightening of domestic financial conditions. For instance, a recent Bank for International Settlements (BIS) study estimated that, for a median developing economy, a 1 per cent appreciation of the debt-weighted exchange rate leads to an increase in quarterly GDP growth of 0.1 per cent in both the short and long run (Kearns and Patel, 2016). Both the trade and financial channels are more prominent in Asia compared with other regions. The financial channel is stronger for developing countries with more foreign currency debt, and it operates strongly through investment.

Large shifts are taking place on the external front, including in trade and capital flows and exchange rates. While some export recovery has been witnessed in recent months, countries in the region cannot rely simply on external demand to drive growth in coming years. Domestic and regional demand will need to play a greater role. At the same time, given the potential benefits of trade, countries in the region should continue to reduce trade costs and roll back the recent increase in trade barriers. Moreover, the gains from trade should be more broadly shared. Trade and technological changes could enable certain sectors to grow while shirking others, forcing the burden of adjustment predominantly onto households that are less mobile (IMF, 2017). Active labour market policies and social protection are thus needed. FDI flows into the region have been relatively robust, but greater effort is needed to ensure that they contribute to expanding the productive capacity of economies and creating decent jobs, including in least developed countries. Non-FDI capital flows have been quite volatile

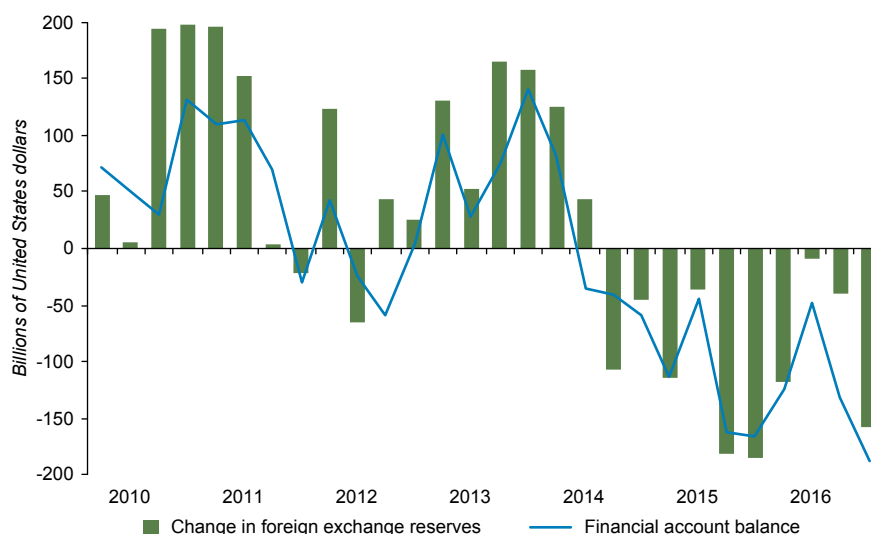
Figure 1.10. Depreciation of regional currencies in the wake of the United States presidential election



Source: ESCAP, based on data from CEIC.

Note: Bilateral exchange rate vis-à-vis the United States dollar.

Figure 1.11. China: Change in foreign exchange reserves and financial account balance



Source: ESCAP, based on data from Bank for International Settlements (2017). *BIS Quarterly Review*, March. Basel, Switzerland.

and their potential impacts, including on corporate balance sheets and domestic private investment, will need to be carefully assessed.

2.4. A modest recovery is under threat

Across the region, economic growth is expected to be slightly more broad-based in 2017 in terms of demand-side components. Leading indicators, such as manufacturing PMIs and the latest export and import

data, point to a mild economic recovery, particularly on the investment side. However, such a recovery is unlikely to be a firm rebound given that the factors which held back domestic demand remain largely unresolved even as rising trade protectionism effectively offsets potential recovery in external demand.

Average economic growth in the developing Asia-Pacific region is projected to rise to 5 per cent in 2017 and 5.1 per cent in 2018 (see table 1.1), underpinned by stable

Table 1.1. Economic growth in the ESCAP region, 2016-2018

(Percentage)	Real GDP growth		
	2016 ^a	2017 ^b	2018 ^b
East and North-East Asia	3.8	3.7	3.6
East and North-East Asia (excluding Japan)	5.9	5.8	5.7
China	6.7	6.5	6.4
Democratic People's Republic of Korea	..	..	..
Hong Kong, China	1.9	2.3	2.5
Japan	1.0	1.0	0.8
Macao, China	-2.1	2.8	5.0
Mongolia	1.2	2.0	3.5
Republic of Korea	2.8	2.5	2.7
North and Central Asia	0.1	1.4	1.7
North and Central Asia (excluding Russian Federation)	1.5	2.9	3.4
Armenia	0.9	2.5	3.0
Azerbaijan	-3.8	0.2	1.2
Georgia	2.7	3.5	3.0
Kazakhstan	1.0	2.0	2.5
Kyrgyzstan	-1.1	3.5	3.7
Russian Federation	-0.2	1.1	1.4
Tajikistan	6.6	5.0	5.2
Turkmenistan	6.2	6.5	6.8
Uzbekistan	7.3	7.4	7.4
Pacific	2.6	2.7	2.9
Pacific island developing economies	2.6	3.1	2.6
Cook Islands	4.2	4.0	1.1
Fiji	2.0	3.6	3.0
Kiribati	3.1	2.7	2.0
Marshall Islands	1.5	2.0	1.6
Micronesia (Federated States of)	2.0	2.5	2.5
Nauru	3.0	15.0	10.0
Palau	2.0	5.0	5.0
Papua New Guinea	2.5	3.0	2.5
Samoa	6.4	2.0	2.0
Solomon Islands	2.7	2.5	3.0
Tonga	3.1	2.6	2.7
Tuvalu	4.0	3.0	3.0
Vanuatu	3.5	3.8	2.5
Developed countries in the Pacific subregion	2.6	2.7	2.9
Australia	2.4	2.5	2.7
New Zealand	4.3	4.5	4.4
South and South-West Asia^c	5.4	5.6	5.9
Afghanistan	2.0	3.0	4.3
Bangladesh	7.1	6.8	6.5
Bhutan	6.4	6.6	7.0
India	7.1	7.1	7.5
Iran (Islamic Republic of)	4.3	4.7	4.4
Maldives	3.9	4.5	4.6
Nepal	0.6	4.6	4.8
Pakistan	4.7	5.2	5.4
Sri Lanka	4.4	4.8	4.9
Turkey	2.4	2.8	3.2
South-East Asia	4.5	4.7	4.8
Brunei Darussalam	-2.0	0.8	1.0
Cambodia	7.2	7.2	7.1
Indonesia	5.0	5.2	5.3
Lao People's Democratic Republic	6.9	6.9	6.8
Malaysia	4.2	4.4	4.5
Myanmar	6.3	7.5	7.6
Philippines	6.8	6.9	7.0
Singapore	2.0	2.2	2.5
Thailand	3.2	3.3	3.4
Timor-Leste	5.0	5.5	6.0
Viet Nam	6.2	6.5	6.7
Memorandum items:			
Developing ESCAP economies^d	4.9	5.0	5.1
Least developed countries	6.0	6.5	6.5
Landlocked developing countries	1.6	3.1	3.6
Small island developing States	2.9	3.4	3.0
Developed ESCAP economies^e	1.3	1.3	1.2
Total ESCAP region	3.7	3.8	3.8

Source: ESCAP, based on national sources; United Nations, Department of Economic and Social Affairs (2017). *World Economic Situation and Prospects 2017*, Sales No. E.17.II.C.2. Available from www.un.org/en/development/desa/policy/wesp/wesp_current/wesp2017.pdf; IMF, International Financial Statistics databases. Available from <http://elibrary-data.imf.org/>; ADB, *Asian Development Outlook 2016* and its updates (Manila, 2016); and CEIC Data Company Limited. Available from www.ceicdata.com.

Note: Aggregate growth rates were calculated using GDP at 2010 United States dollars as weights, a change from the previous calculation using GDP at 2005 prices. The update better reflects the current structure of the economies closer to the base period and provides a more accurate measure of growth. A notable change is evident in the increase in China's weight among the Asia-Pacific developing economies and is consistent with China's remarkable growth to become the world's second largest economy. The shift in the base year thus resulted in increased aggregate growth by approximately 0.1 percentage point compared with the previous base year.

^a Estimate.

^b Forecasts (as of 30 March 2017).

^c The estimates and forecasts for countries relate to fiscal years defined as follows: 2016 refers to the fiscal year spanning the period from 1 April 2016 to 31 March 2017 for India; from 21 March 2016 to 20 March 2017 for Afghanistan and the Islamic Republic of Iran; from 1 July 2015 to 30 June 2016 for Bangladesh, Bhutan and Pakistan; and from 16 July 2015 to 15 July 2016 for Nepal.

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

^e The group of developed ESCAP economies consists of Australia, Japan and New Zealand.

economic conditions in China, where higher value-added sectors are gradually replacing excess capacity sectors as the driver of output, employment and export growth. Projected moderation in China reflects mostly ongoing efforts to deleverage and restructure the economy, which could boost growth in the medium term. In India, a gradual recovery from an estimated 7.1 per cent growth rate in 2016 is projected, as remonetization will restore consumption, but a revival in investment will take longer given unresolved problems in the banking sector. A slightly improved growth outlook for the rest of the region is due to a recovery in net commodity-exporting economies and public investment in some of the net commodity-importing economies. Among developed Asia-Pacific economies, growth in Japan is projected to strengthen in line with improved labour market conditions (see chapter 2 for more details).

Despite the broadly positive economic outlook for 2017 and 2018, the likely impact of some risks for the near-term economic outlook should not be underestimated. With a significant increase in global policy uncertainty in recent months, the risks to the outlook are tilted to the downside.

The most significant risk is trade protectionism.⁵ Recent shifts in United States policy over trade, currency, immigration and other areas could have large potential impacts on the region, including for China's goods exports and India's services exports. Possible further shifts in United States policy, together with Brexit and upcoming elections in various European countries, have also resulted in heightened global uncertainty, which in itself undermines investment in the region. Any foregone trade and investment in turn could hurt employment prospects and act as a drag on productivity growth in the years to come. Based on simulations, average economic growth in developing Asia-Pacific economies in 2017 could be up to 1.2 percentage points slower than the baseline projections if an increase in trade protectionism and global economic uncertainty is steeper than anticipated (see box 1.4).

All this comes at a time of potential tightening of global financial conditions, which could effectively bring to an end the region's cycle of monetary easing. Capital outflow pressures, which increased in the wake of the United States election before subsiding recently, are likely to re-

emerge with the announcement by the United States of fiscal stimulus and lead to further depreciation of regional currencies against the United States dollar. This outcome is expected to be accompanied by bouts of financial volatility, arising from any deviations of actual policy from market expectations.⁶ The United States raised its federal funds rate in March 2017 for the second time since the United States election in November 2016 and only the third time in a decade. The median expectation is that there will be two more rate increases in 2017. There is also a chance that sovereign yields in Europe could rise on the back of more expansionary fiscal stances and that the European Central Bank (ECB) may not extend its quantitative easing beyond 2017. Countries in the region with large current account deficits and high short-term external debt are particularly vulnerable.

On the upside, regional exports could benefit from stronger external demand and currency-induced competitiveness, but any boost is likely to be limited by trade protectionist measures. Currency depreciation could also further limit monetary policy space, not least due to its inflationary impact.

Within the region, China's role as originator and transmitter of shocks has increased in recent years. Real or perceived economic instability in China could lead to bouts of financial volatility in the region, as witnessed in early 2016. In view of the fact that several regional economies are competing with China in global value chains, depreciation of the renminbi puts pressure on other regional currencies to also depreciate. On the upside, if China's economic performance is stronger than expected, as in 2016, there could be positive trade spillovers.

In the medium term, strengthening domestic and regional demand will be critical in the face of a tough external environment. In this regard, China's rebalancing and opening augurs well for the region. The Belt and Road Initiative could provide renewed momentum for regional connectivity and intraregional trade, while China's capital account liberalization could dramatically increase the pool of long-term financing available for investment in the region. The future of regional demand also depends largely on whether South Asia realizes its full potential, for which regional economic cooperation and integration could critically complement domestic efforts.

Box 1.4. Alternative economic growth scenarios for developing Asia-Pacific economies in 2017

Although the baseline projections would seem to predict higher economic growth in developing Asia-Pacific economies in 2017, the region is set to face two key external downside risks. These risks are increased trade protectionism and heightened economic policy uncertainty in developed economies. While the baseline projections did take into account these developments to some extent, a sharper-than-expected increase in the degree of protectionism and uncertainty is possible. For example, several major developed and developing countries are considering non-tariff measures (NTMs) with unclear effective dates.^a With regard to uncertainty, an example includes unexpected electoral outcomes that might lead to policy surprises, reversal of announced policies and unanticipated market reactions to known policy changes.

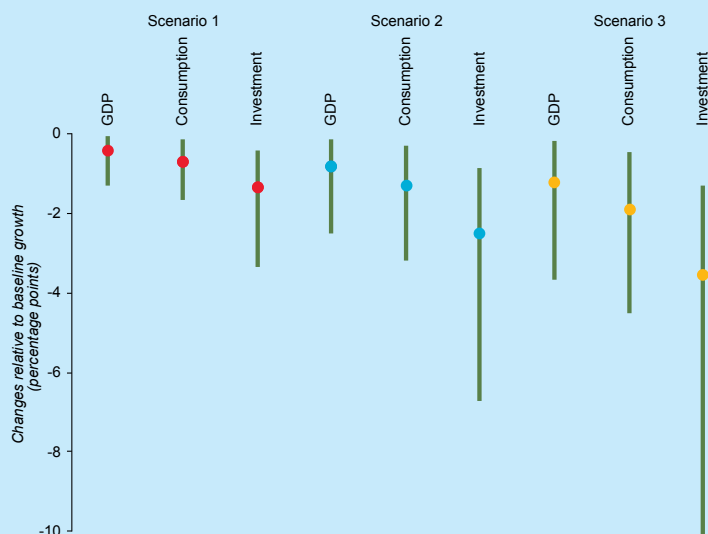
Sharper-than-expected increases in the degree of trade protectionism and economic uncertainty – if they materialize – would result in output growth that is below the baseline projections. In economies with a large export-oriented sector and high domestic content in export products, the adverse impact of trade protectionism on domestic employment conditions could be notable. In highly uncertain economic conditions, consumers also face increased job insecurity that deters their spending on durable goods and housing. Given less predictable demand, businesses are reluctant to expand production capacity, especially if excess capacity is already large. Finally, banks also tighten lending standards as perceived default risks rise.

To quantify the impact that the two risk factors could have on the projected economic growth in developing Asia-Pacific economies in 2017, three simulation scenarios were created using the Oxford Global Economic Model. These scenarios assume: a decline in merchandise exports following greater use of non-tariff trade barriers; a rise in the risk premium on a country's foreign debt amid a higher degree of risk aversion among global investors; and deteriorating domestic market confidence. The difference across the three scenarios is the assumed magnitude of changes in these variables.

In particular, while in the first scenario it is assumed that stronger-than-expected trade protectionism is confined to developed markets, in the second scenario it is assumed that developing Asia-Pacific economies themselves also introduce more trade-restrictive measures than had been expected. Such across-the-board rises in trade protectionism push up the risk premium and dent market confidence significantly. Finally, in the third scenario it is assumed that the levels of export declines are the same as those in the second scenario but feature an even higher risk premium and weaker market confidence.^b

Under the first scenario, output growth in 14 developing Asia-Pacific economies in 2017 could be about 0.4 percentage points lower than the baseline case.^c The magnitude of such a negative growth impact increases to 0.8 and 1.2 percentage points in the second and third scenarios respectively. In addition to the assumed export decline, projected economic growth is weighed down by more sluggish expansion in private consumption and gross fixed capital investment as a result of weaker market sentiment and higher financing costs (see figure below).

Alternative growth scenarios for developing Asia-Pacific economies in 2017



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

Note: The vertical lines show the ranges of macroeconomic variables in 14 developing economies in the region in 2017. The dots on the lines represent the group-average values. The baseline projections are based on forecasts in the Oxford Model.

Box 1.4. (continued)

Slower economic growth in turn could adversely affect employment and wage prospects. At the global level, it is estimated that lower consumption and investment demand could increase unemployment by an addition 0.3 million persons in 2017 and almost 1 million in 2018 (ILO, 2017b). In developing countries, more relevant indicators could be the potential increases in underemployment and informal sector jobs during economic downturns. Employment generation is also likely to slow. Under the third scenario, it is estimated that employment growth in 14 developing Asia-Pacific economies in 2017 could be 0.3 percentage points lower than the baseline case, which is fairly significant given that average employment growth in the region in 2016 was 1.1 per cent.

^a See the WTO Integrated Trade Intelligence Portal (I-TIP). Available from www.wto.org/english/res_e/statis_e/itip_e.htm.

^b In the first scenario it is assumed that a country's exports to developed countries are 10 per cent lower than the baseline levels, the risk premium rises by 100 basis points and the confidence index declines by 5 points on a common 0-100 scale. In the second scenario it is assumed that exports to developed markets and developing Asia-Pacific economies are 15 and 10 per cent lower than their baseline levels respectively, while the risk premium rises by 150 basis points and the confidence index declines by 10 points. In the third scenario it is assumed that the latter two figures are 200 basis points and 15 points respectively.

^c The 14 economies are: China; Hong Kong, China; India; Indonesia; the Islamic Republic of Iran; Malaysia; Pakistan; the Philippines; the Republic of Korea; the Russian Federation; Singapore; Thailand; Turkey; and Viet Nam. Together, they account for nearly 96 per cent of total output in developing Asia-Pacific economies.

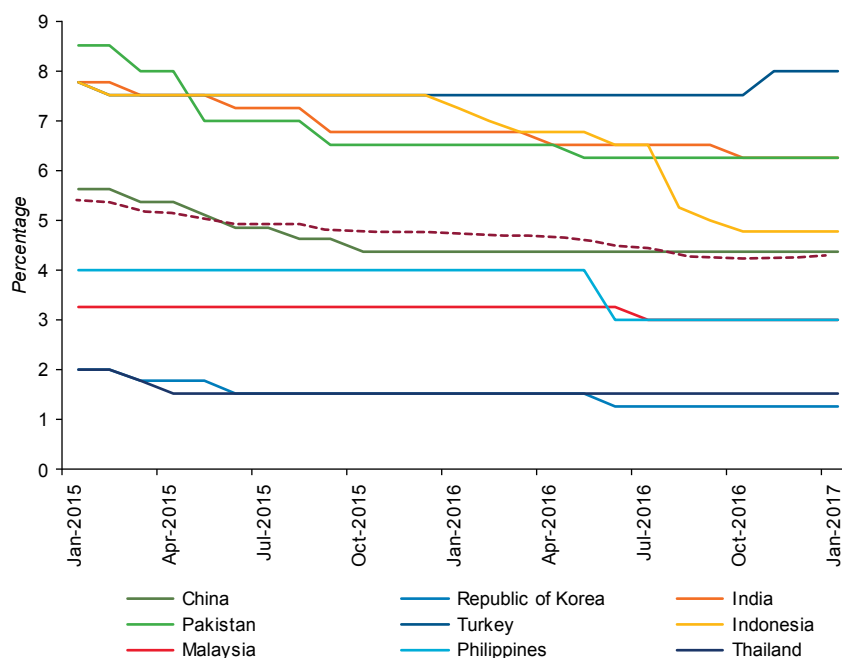
3. ECONOMIC POLICY CONSIDERATIONS

3.1. Monetary policy space and efficacy are declining

Monetary policy stances in the region have recently shifted from "accommodative" to "neutral" as upside risks

to inflation increased. In the first three months of 2017, policy interest rates were on hold in India, Indonesia and the Philippines, while short-term interest rates increased in China, in contrast to the previous two years when policy rates were lowered consecutively or kept at record low levels in these economies plus others such as Pakistan, the Republic of Korea and Thailand (see figure 1.12). Average inflation in developing Asia-Pacific economies is projected to rise from 3.6 per cent in 2016 to 3.8 per cent

Figure 1.12. Policy interest rates



Source: ESCAP, based on data from CEIC and national central banks.

Note: Mean value of policy rates of these nine economies is shown by the dashed line. China is at the median throughout the period. The marked drop in Indonesia's policy rate in August 2016 was due to the adoption by Bank Indonesia of the seven-day reverse repurchase rate as its new benchmark.

in 2017 and 2018 (see table 1.2). The uptick is more evident if the average excludes North and Central Asia, where inflation has been subsiding after large currency depreciations prompted high inflation in the previous two years. In India, stronger inflationary pressure in recent months also reflected the remonetization of the economy, which spurred consumption demand. In China, although the overall monetary policy stance was neutral (with no changes in the benchmark deposit and lending rates), short-term money market rates were increased to curb capital outflows and ease downward pressure on the renminbi.

While global commodity prices have largely stabilized since 2016, they remain a source of upside or downside risk depending on whether a country is a net commodity exporter or importer. If global oil prices overshoot baseline projections of \$55 per barrel, net importers of oil in the region would face higher inflation but net exporters would see faster economic recovery (see figure 1.13). Despite the OPEC production limitation agreement, large inventories and the availability of shale oil in the United States have so far limited further price rises.

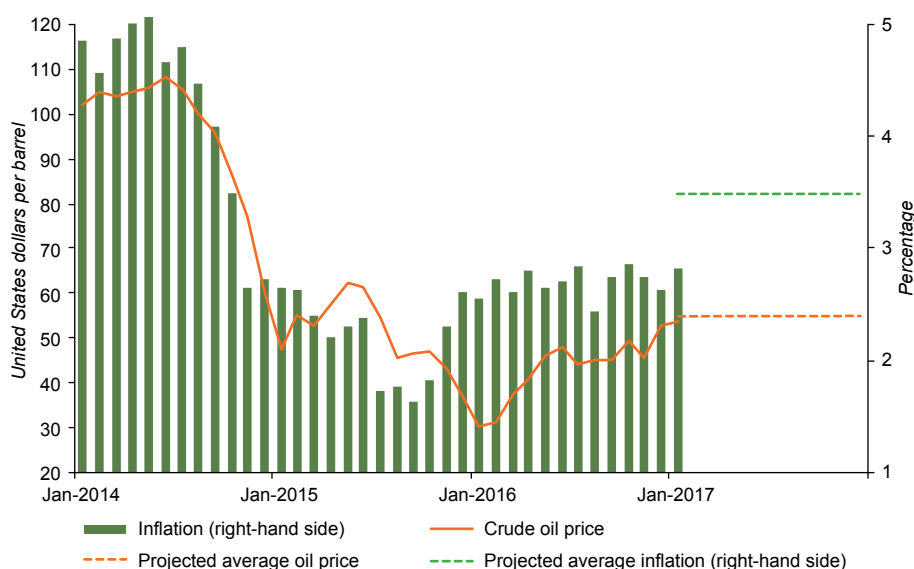
In any case, the boost from low inflation and supportive monetary stances has been smaller than expected. For instance, countries which underwent disinflation or reduced their interest rate did not necessarily see output growth accelerate in the following year (see figure 1.14). Possible reasons include relatively weak growth in real wages and farm incomes on the consumption side and

uncertainty and excess capacity on the investment side. In some countries, private sector debt overhang was also a major factor. In particular, private investment has not been forthcoming in many countries.

The recent uptick in inflation, though mostly due to non-domestic demand factors, such as oil prices and exchange rate depreciation, calls for caution. Likely currency depreciation could further limit monetary policy space, not least due to its inflationary impact. Nevertheless, raising policy rates would be difficult as well. For instance, leveraged households and firms could find that debt service costs will rise and refinancing become more difficult, thus increasing financial stability risks (see figure 1.15). Economies are therefore advised to maintain the status quo in terms of policy interest rates. At the same time, they should consider strengthening the management of capital flows and macroprudential measures to mitigate the adverse effects of exchange rate depreciation and to ensure financial stability (ESCAP, 2016c).

A potential source of financial instability in the near future may be worries about excessive indebtedness. In 2016, global total debt stood at record levels of \$152 trillion or 225 per cent of global GDP (IMF, 2016). Furthermore, a specific vulnerability of debt accumulation is that, although issuance of local currency bonds has increased, considerable volumes of debt have been issued in hard currency, mostly the United States dollar. The interest rate hikes in the United States, together with the strong dollar, could spark a trend reversal. Within the region,

Figure 1.13. Crude oil price and average inflation in selected net commodity importers



Source: ESCAP, based on CEIC and IMF data.

Note: Projected average crude oil price of \$55 per barrel in 2017. Unweighted average inflation in China, India, Pakistan, Philippines and Republic of Korea, with the projection for 2017 based on table 1.2.

Table 1.2. Inflation in the ESCAP region, 2016-2018

(Percentage)	Inflation ^a		
	2016 ^b	2017 ^c	2018 ^c
East and North-East Asia	1.0	1.6	1.8
East and North-East Asia (excluding Japan)	1.9	2.2	2.4
China	2.0	2.3	2.5
Democratic People's Republic of Korea	..	..	..
Hong Kong, China	2.4	2.5	2.7
Japan	-0.1	0.8	0.9
Macao, China	2.4	2.0	2.0
Mongolia	1.1	4.5	5.3
Republic of Korea	1.0	1.9	2.0
North and Central Asia	7.8	5.4	4.8
North and Central Asia (excluding Russian Federation)	11.6	7.2	6.6
Armenia	-1.4	1.5	3.0
Azerbaijan	12.4	7.9	5.8
Georgia	2.2	3.2	3.2
Kazakhstan	14.7	6.8	6.2
Kyrgyzstan	0.4	1.3	3.0
Russian Federation	7.1	5.0	4.5
Tajikistan	6.0	5.0	4.5
Turkmenistan	4.2	5.7	5.9
Uzbekistan	11.5	12.5	12.0
Pacific	1.3	1.9	2.3
Pacific island developing economies	5.3	5.5	5.0
Cook Islands	-0.3	1.6	1.5
Fiji	3.9	2.5	2.5
Kiribati	1.5	1.8	2.1
Marshall Islands	-1.3	1.0	1.8
Micronesia (Federated States of)	-0.3	1.5	1.9
Nauru	6.6	1.7	1.7
Palau	1.5	2.5	2.5
Papua New Guinea	6.9	7.5	6.6
Samoa	1.3	2.3	2.3
Solomon Islands	3.3	4.5	3.8
Tonga	2.0	1.9	3.2
Tuvalu	3.5	3.0	2.8
Vanuatu	1.9	2.4	2.6
Developed countries in the Pacific subregion	1.2	1.9	2.2
Australia	1.3	1.9	2.3
New Zealand	0.6	1.5	1.7
South and South-West Asia^d	6.1	6.9	6.6
Afghanistan	6.0	6.5	6.5
Bangladesh	5.9	5.8	5.5
Bhutan	4.0	4.5	5.0
India	5.0	5.3	5.5
Iran (Islamic Republic of)	8.5	9.2	9.2
Maldives	0.5	2.9	3.7
Nepal	9.7	8.5	8.0
Pakistan	2.9	5.0	5.5
Sri Lanka	4.0	5.0	5.3
Turkey	7.8	9.7	8.0
South-East Asia	2.1	3.2	3.5
Brunei Darussalam	-0.7	0.5	1.2
Cambodia	3.0	3.4	4.0
Indonesia	3.5	4.2	4.4
Lao People's Democratic Republic	1.6	2.1	2.6
Malaysia	2.1	3.2	3.4
Myanmar	7.2	8.5	8.5
Philippines	1.8	3.2	3.4
Singapore	-0.5	1.0	1.2
Thailand	0.2	1.5	2.0
Timor-Leste	-0.6	1.3	3.8
Viet Nam	2.7	4.0	4.5
Memorandum items:			
Developing ESCAP economies^e	3.6	3.8	3.8
Least developed countries	6.1	6.4	6.3
Landlocked developing countries	11.1	7.2	6.6
Small island developing States	4.4	5.0	4.8
Developed ESCAP economies^f	0.1	1.0	1.1
Total ESCAP region	2.5	2.9	2.9

Source: ESCAP, based on national sources; United Nations, Department of Economic and Social Affairs (2017). *World Economic Situation and Prospects 2017*, Sales No. E.17.II.C.2. Available from www.un.org/en/development/desa/policy/wesp/wesp_current/wesp2017.pdf; IMF, International Financial Statistics databases. Available from <http://elibrary-data.imf.org>; ADB, Asian Development Outlook 2016 and its updates (Manila, 2016); and CEIC Data Company Limited. Available from www.ceicdata.com.

Note: Aggregate growth rate calculated using 2010 United States dollars (GDP weights).

^a Annual average of changes in consumer price index.

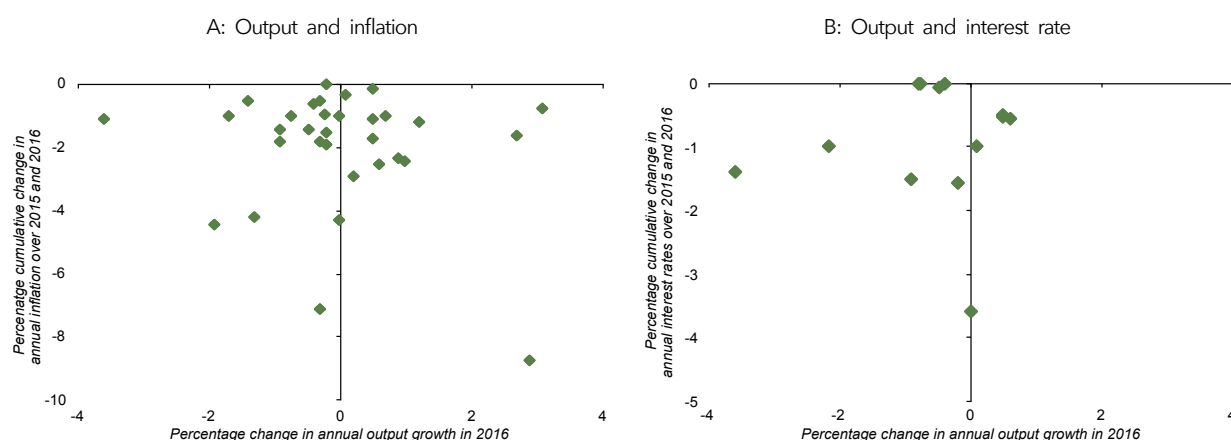
^b Estimate.

^c Forecasts (as of 30 March 2017).

^d The estimates and forecasts for countries relate to fiscal years defined as follows: 2016 refers to the fiscal year spanning the period from 1 April 2016 to 31 March 2017 for India; from 21 March 2016 to 20 March 2017 for Afghanistan and the Islamic Republic of Iran; from 1 July 2015 to 30 June 2016 for Bangladesh, Bhutan and Pakistan; and from 16 July 2015 to 15 July 2016 for Nepal.

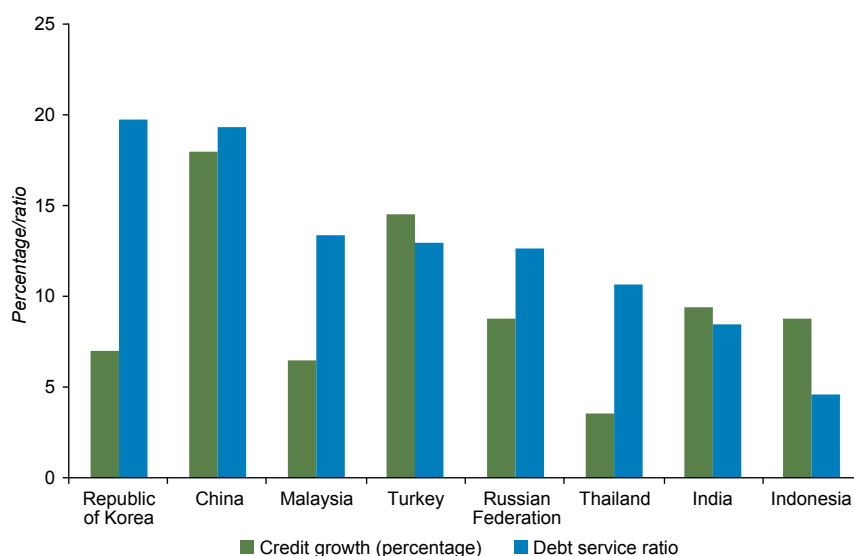
^e Developing ESCAP economies consist of all countries and areas listed in the table, excluding Australia, Japan and New Zealand.

^f The group of developed ESCAP economies consists of Australia, Japan and New Zealand.

Figure 1.14. Output, inflation and interest rates

Source: ESCAP, based on data from CEIC and table 1.1.

Note: Percentage point differences between real GDP growth in 2015 and 2016. The figure does not show regional economies which underwent cumulative inflation over 2015 and 2016 or policy interest rate increases since January 2015.

Figure 1.15. Credit growth and debt service ratio

Source: ESCAP, based on data from the Bank for International Settlements and CEIC.

Note: Credit growth refers to domestic credit growth (percentage) as of December 2016. Debt service ratio is for the non-financial private sector.

some remedial measures and deleveraging have been introduced. Banking supervision has been strengthened in China and India, including through more rigorous assessment of bank asset quality. Countries are also addressing non-performing loans and other distressed assets, including through increased provisioning. However, such measures could produce negative short-term impacts on economic growth and investment.

3.2. Fiscal space should be used effectively

Fiscal policy could further play an active role in stabilizing the economy and supporting development priorities, but its effectiveness depends critically on good governance. Fiscal policy stances in the region have been broadly countercyclical and expansionary in recent years. China implemented large infrastructure projects and tax breaks;

India adjusted its medium-term fiscal consolidation path to accommodate higher current expenditures; and the Republic of Korea and Thailand engaged in various stimulus measures. However, net commodity exporters have taken a more cautious approach in view of the terms-of-trade losses that have affected public finances. Beyond stabilization considerations, there have also been efforts to enhance the composition and quality of public expenditures in support of development priorities (see box 1.5). However, there is substantial variation across the

region, with combined education and health expenditures at about or below 5 per cent of GDP in some countries (see figure 1.16). Social protection spending and coverage also remain low, with large gaps in the informal sector, as will be discussed in greater detail in the next section.

Ensuring fiscal sustainability requires tax reforms and effective debt management, keeping in mind the potential positive spillovers of social and infrastructure investments on the economy. Tax collection remains relatively low in the

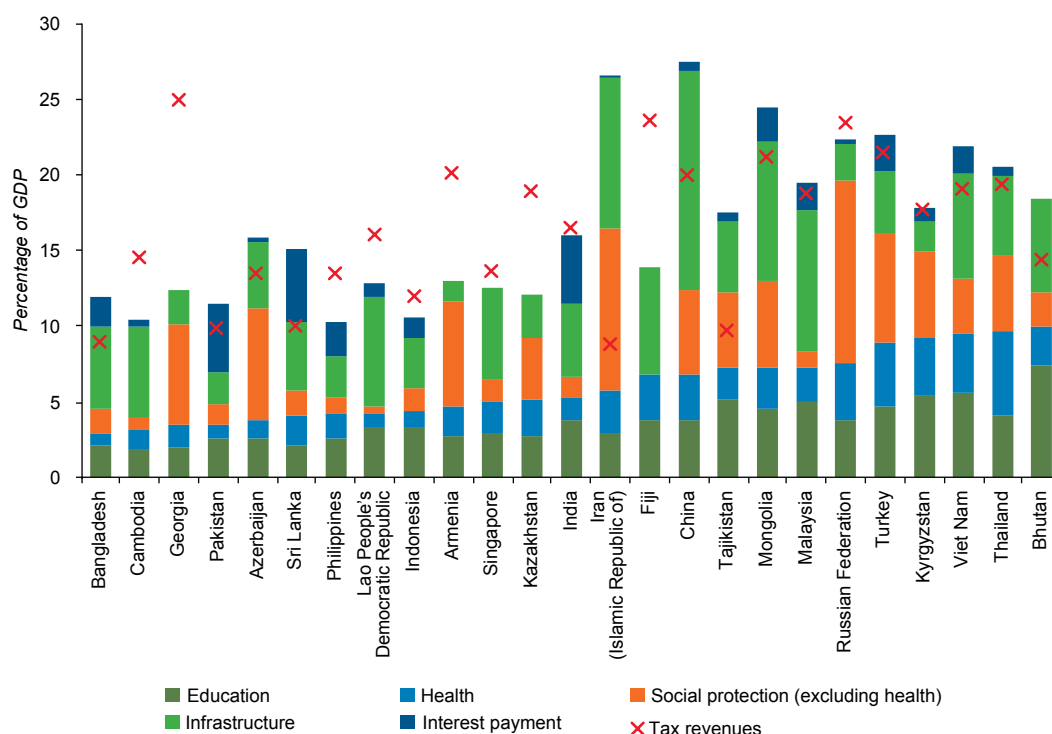
Box 1.5. Highlights of government budgets

In Asia and the Pacific, fiscal stances during recent years have generally been countercyclical and expansionary, which bolstered the region's resilience to different shocks. China has pushed ahead with large infrastructure projects while providing tax breaks and other relief measures for firms and consumers, which resulted in a wider fiscal deficit of about 3 per cent of GDP in 2016. With a view to supporting the building of "a moderately prosperous society in all respects", the budget emphasized spending on education, science and technology, health care, poverty alleviation, social security and employment (China, 2016). Although the country's general government debt is relatively low, there are concerns about local government debt and contingent liabilities, which are being addressed with a revised fiscal law. The overall fiscal stance is expected to remain expansionary in the near term to stabilize the economy and to invest in social and infrastructure sectors. A special fund has also been set up to compensate for layoffs in sectors undergoing capacity reduction.

In India, the government budget contains several growth-supporting measures, especially for the rural sector, despite constraints posed by relatively high public debt and low tax revenues. As a remarkable step towards universal health coverage, a health insurance scheme was introduced to cover one third of the population when people have to make hospitalization expenditures, and a universal basic income scheme is under consideration (India, Ministry of Finance, 2017a). To accommodate such ambitious programmes, the Government is reprioritizing expenditures (by phasing out fuel subsidies, for instance), enhancing expenditure efficiency (such as by reducing leakages through direct benefit transfers) and pursuing tax reforms – to boost revenues by curbing tax evasion (for example, through demonetization), reducing distortions (by imposing a nationwide goods and services tax, for example) and enhancing progressivity (such as by adding a surcharge on top incomes). For the 2017/18 budget, the Government is pursuing a milder consolidation target to support growth (India, Ministry of Finance, 2017b).

Net commodity exporters, such as Indonesia and the Russian Federation, have taken a more cautious approach in view of changes in the terms of trade in recent years. Those changes have adversely affected public finances through revenue shortfalls and smaller differential between the effective interest rate and the nominal GDP growth rate. Indonesia has successfully phased out its fuel subsidies and reallocated the savings to infrastructure and social spending. Amid persistent revenue shortfalls however, the budget was revised to meet the legal deficit ceiling of 3 per cent of GDP. In the ESCAP Survey for 2016 it was argued that some flexibility may be warranted given the relatively low levels of public debt and the need for large public investments – through a cyclically adjusted deficit rule for example, or exclusion of priority outlays from the perimeter of the rule (ESCAP, 2016c). While views may differ on this point, it is clear that weak tax revenue has become a key fiscal risk. Efforts to boost revenues, such as the recent tax amnesty programme, have had limited success. In the Russian Federation, the impact of lower oil prices on the national budget was mitigated as the Government drew on past windfall savings. Nevertheless, the budget for 2017 and the medium-term expenditure framework for the period 2017-2019 target consolidation through a mix of expenditure cuts and revenue mobilization efforts.

Net commodity importers, which have benefited from lower oil prices, have generally pursued an expansionary fiscal policy. Thailand implemented tax incentives aimed at stimulating private investment and quasi-fiscal measures, such as subsidized loans for farmers and small and medium-sized enterprises. One fifth of the 2017 budget is earmarked for capital expenditures to support a multi-year infrastructure development plan. The budget of the Philippines has increased rapidly in recent years on the back of strong economic growth and tax revenues. The 2017 budget contains large increases for police, education and infrastructure. In Bangladesh, the budget contains large increases for education and health, although much of it is driven by increased compensation for government employees. In the Survey for 2016 it was suggested that, in addition to such indicators as the cost of living, Governments could also compare the wage bill with the size of selected non-compensation expenditures administered by employees (ESCAP, 2016c).

Figure 1.16. General government spending and revenues

Source: ESCAP, based on national sources, International Monetary Fund, Fiscal Monitor database. Available from www.imf.org/external/pubs/ft/fm/2011/02/app/FiscalMonitoring.html (accessed 1 February 2017); World Economic Outlook database. Available from www.imf.org/external/pubs/ft/weo/2016/02/weodata/index.aspx (accessed 1 February 2017); and Investment and Capital Stock Dataset. Available from www.imf.org/external/np/fad/publicinvestment/data/data.xlsx (accessed 1 February 2017); United Nations Educational, Scientific and Cultural Organization, UNESCO Institute for Statistics (UIS) database. Available from <http://uis.unesco.org/> (accessed 1 February 2017); International Labour Organization, Social Protection Platform. Available from www.social-protection.org/gimi/gess/ShowTheme.action?id=10 (accessed 1 February 2017); and World Bank, World Development Indicators database. Available from <http://data.worldbank.org/> (accessed 1 February 2017).

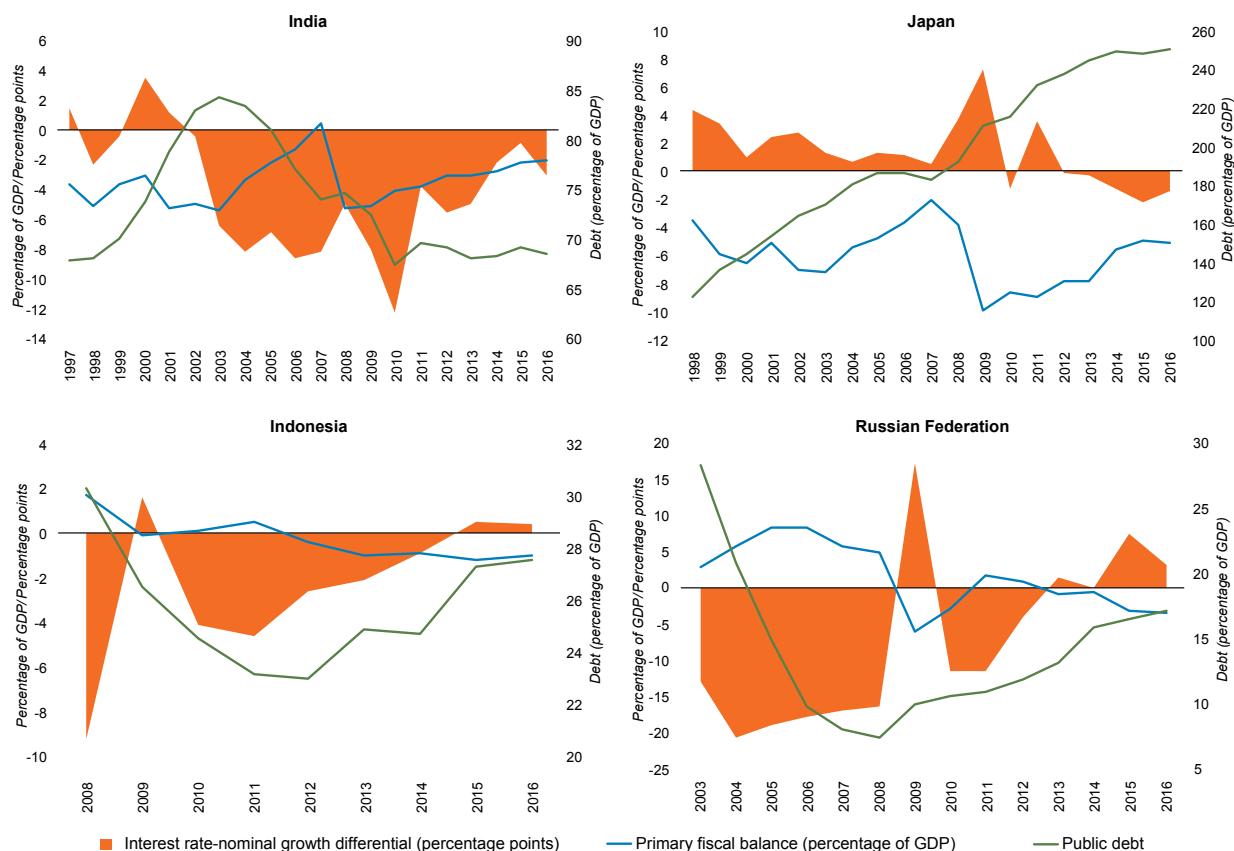
Note: The year 2015 or latest available year for social spending (on education, health and social protection) and tax revenues. Latest three-year average (2012-2015) for public investment and interest payments. Public investment covers social infrastructure (e.g. schools and hospital buildings) as well as economic infrastructure (e.g. roads and railways), thus overlapping somewhat with social spending. Countries are sorted by the sum of education and health spending only. Social protection, excluding health, is considered separately, given that in many countries it consists mostly of social insurance, such as pensions for public sector employees, and offers only limited coverage. While only tax revenues are indicated, some countries have significant non-tax revenues, including from the resources sector. Also in the case of public investment, State-owned enterprises play an important role such that funding is not entirely reliant on government revenues. Tax revenues include social security contributions, which are fairly small in most countries, except in transition economies. Interest payment is on total general government liabilities.

Asia-Pacific region and the scope for boosting revenues through improved compliance and base-broadening is particularly large (ESCAP, 2014a; 2016c). In countries where domestic demand is depressed, some tax relief could be offset by debt finance, taking advantage of the relatively low government bond yields in recent years – although the window of opportunity here may be narrowing. The trajectory of government debt depends, among other things, on two variables:⁷ (a) the differential between the effective interest rate and the nominal GDP growth rate; and (b) the primary fiscal balance.⁸

While running primary deficits could be desirable from a stabilization or development viewpoint, it does make Governments dependent on economic growth and favourable interest rates to contain the debt ratio. This situation has been a concern in some countries, as

economic growth slowed and disinflation occurred in recent years. In India, the debt to GDP ratio stopped declining in the wake of the global financial crisis of 2008 as the differential narrowed and the primary deficit widened; in Japan, it has continued to rise to very high levels (see figure 1.17). In contrast, Indonesia and the Russian Federation have fairly low debt levels, but the debt trajectory has made a clear turn following large terms of trade losses – which explains why the authorities are pursuing conservative budgets.

In assessing fiscal sustainability, countries could consider the potential positive spillovers of social and infrastructure investments on the economy. If the spillovers are sufficiently large, for instance due to the “crowding in” of private investment, the public debt to GDP ratio could be stable over the long term. It has been argued that the current

Figure 1.17. General government debt

Source: ESCAP, based on CEIC, IMF and Government of India *Economic Survey 2016-17*.

Note: Primary fiscal balance is the overall budget balance, excluding interest payments on consolidated government liabilities. The differential is expressed in reverse, that is, $r-g$ rather than $g-r$, for easier comparison with primary deficit. Data for 2016 are estimates.

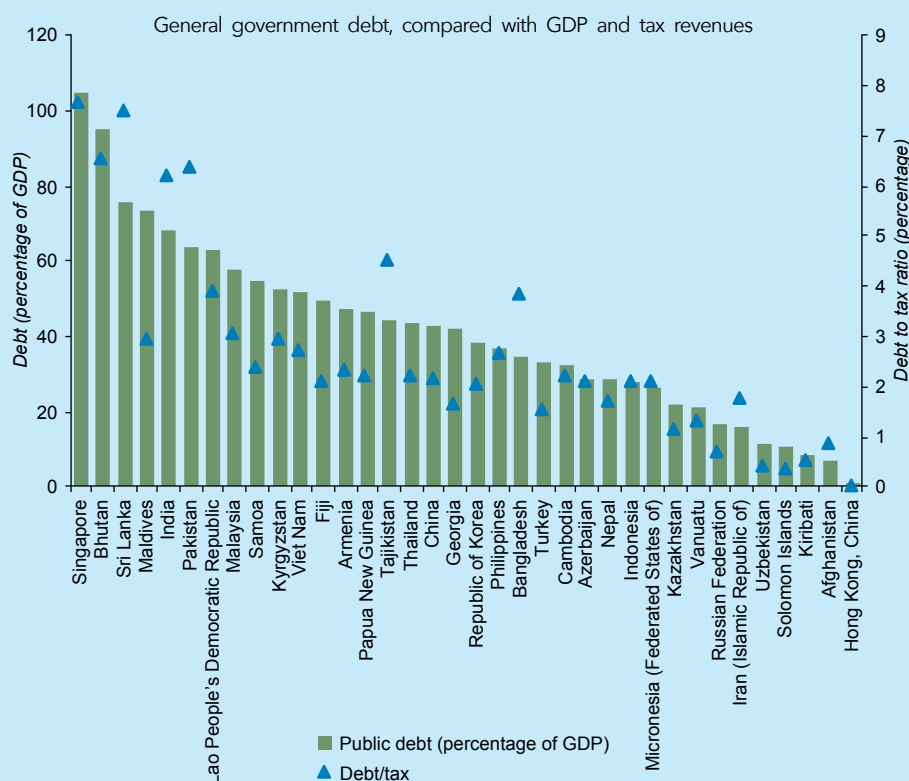
environment of weak external demand, weak private investment, low borrowing costs and benign inflationary pressures supports the case for greater public investment, including in infrastructure (ESCAP, 2016d). However, this is an area where more research is needed given the mixed empirical evidence (see box 1.6).

The literature points to higher multipliers for capital expenditures compared with current expenditures. A key question is whether public investment does in fact “crowd in” private investment and if so, to what extent. This would also depend on how the public outlays are financed – through additional revenue collection,

Box 1.6. Fiscal space and fiscal multipliers

Fiscal sustainability, particularly debt sustainability, depends on several factors. While conventional approaches to estimating the “sustainable” debt threshold, such as taking the mean or median debt to GDP ratio of a defined peer group, could be useful as a reference, such illustrative estimates should not be taken as de facto thresholds. In assessing fiscal sustainability or fiscal space, Governments are advised to refer to various alternative measures which could provide a different picture (DESA, 2017). For instance, the ability-to-pay model, which estimates the level of debt in which the primary balance adjustment would be insufficient to offset growing debt service (Ghosh and others, 2013) could provide a different picture from the tax-years model, which compares public debt levels to the number of tax years a Government needs to repay its debt (Aizenman and Jinjark, 2010). For instance, according to the tax-year model, the Maldives may have more fiscal space than Pakistan despite having a higher debt to GDP ratio (see figure next page).

Another consideration in assessing fiscal sustainability is the concept of fiscal multipliers, which measure the short-term impact of discretionary fiscal policy on output. As illustrated above, the debt trajectory depends critically on

Box 1.6. (continued)

Source: ESCAP, based on IMF Fiscal Monitor Database. Available from www.imf.org/external/pubs/ft/fm/2016/02/fmindex.htm (accessed 1 February 2017).

the nominal GDP growth rate. Estimation of multipliers is important for macroeconomic projections and policy design. For instance, the underestimation of fiscal multipliers early in the global crisis contributed significantly to growth forecast errors (Blanchard and Leigh, 2013). However, there is little consensus in the literature on the size and persistence of multipliers. For instance, Ricardian equivalence and possible “crowding out” effects would suggest negligible or even negative multipliers.^a In recent papers, however, it has generally been found that multipliers tend to be higher during recessions, especially if monetary policy is constrained by the zero lower bound (Christiano, Eichenbaum and Rebelo, 2011). In that context, it has been suggested that fiscal activism can partly pay for itself (Gaspar, Obstfeld and Sahay, 2016).

Empirical evidence is limited for developing economies, and it is unclear from a theoretical viewpoint whether multipliers should be expected to be higher or lower than in the developed economies (Batini and others, 2014). While lower capital stocks would imply higher returns, developing economies also tend to suffer from inefficiencies in public expenditure management and revenue administration. In developing economies, monetary policy is rarely near the zero lower bound, which is a controversial concept in itself, making the size of the fiscal multiplier smaller. Existing multiplier estimates for countries in the Asia-Pacific region are in fact closer to zero than 1. On average, the multiplier is above 1 only in China, about 0.5 in the Republic of Korea and the Philippines, about zero in Indonesia and Thailand, and negative in Singapore (Wang and Wen, 2013; Tang, Liu and Cheung, 2010).

Another possible explanation for low multipliers is the prominence of policy objectives other than output stability. Indeed, fiscal policy in developing economies could be more concerned about supporting development priorities than just stabilizing output – in which case, fiscal performance would be better assessed through such indicators as public expenditure efficiency instead of multipliers, as shown in chapter 3 for such areas as education and health. It could also be the case that some of the dynamic, long-term effects of fiscal policy on output are not captured in the short-term multiplier. For instance, if ambitious social and infrastructure spending results in large positive spillovers into the economy, the debt to GDP ratio could eventually fall below the baseline case (ESCAP, 2013).

^a For Ricardian equivalence, it is assumed that individuals anticipate future tax increases and thus save and reduce consumption in the case of debt issuance and deficit financing. The crowding out effect refers to a situation when higher public expenditures, caused by increasing interest rates, lead to a reduction in private investment spending such that it dampens the initial increase in total investment spending.

borrowing or a mix of these. Another consideration is the pace of investment (front-loading or gradual), with some empirical studies supporting the latter based on the assumption that this would allow time for improving efficiency (Ghazanchyan and others, 2017). While more research is required to answer these questions, data suggest that it is not just public investment (flow), but the total public capital stock which matters for private investment (see figure 1.18). This thinking is in line with theoretical models of economic growth in which capital stock is a direct input factor of the production function, contributing to higher productivity growth.

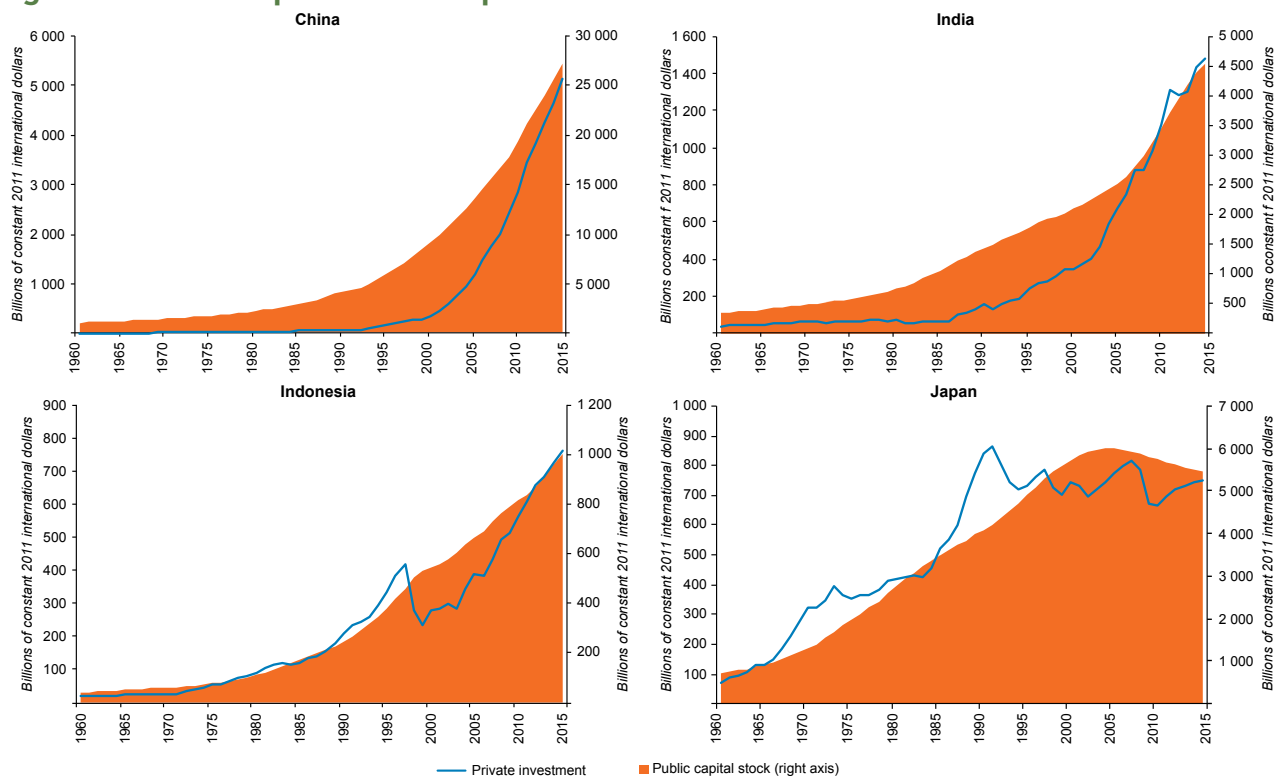
3.3. Structural reforms could lift productivity

To achieve economic health, countries often need to make changes in the basic structure of their economies. Structural reforms are measures that are aimed at raising productivity by improving the technical efficiency of markets and institutional structures, or by reducing impediments to the efficient allocation of resources (Rajan, 2004). These range from measures as diverse as reforms on banking supervision and laws on property rights to changes in tariff rates or rules on hiring and firing.⁹

Interest in structural reforms has increased in recent years amid the slowdown in productivity growth and the decline in potential growth. For developing Asia-Pacific economies, it was estimated in ESCAP (2016c) that growth in total factor productivity (TFP) declined by more than half between the period 2000-2007 and that of 2008-2014 while growth in labour productivity declined by a third over the same time frame. It was argued that, although cyclical elements may also be in play, structural constraints, such as in skills and infrastructure, seem to be holding back the productivity potential of the region. Weak governance has been identified as another potential constraint, as it could undermine productivity-enhancing innovation and investment (ESCAP, 2016d) (see also chapter 3).

Structural reforms are not new to the Asia-Pacific region.¹⁰ In fact, reforms were critical to the region's unprecedented structural transformation in recent decades. Countries such as Malaysia and the Republic of Korea – and more recently, China – have constantly upgraded their economic structures through appropriate policy and regulatory changes and forward-looking investments. Reform often started with the rural and agricultural sectors.

Figure 1.18. Public capital stocks and private investment



Source: ESCAP, based on IMF capital stock and investment dataset.

Note: The shaded area shows public capital stock. The line represents private investment flows. Both are estimates from 1960 to 2015.

For instance, in China the decentralization of agricultural production and liberalization in the pricing and marketing of agricultural goods in the late 1970s and early 1980s resulted in large increases in agricultural growth and farm incomes (Von Braun, Gulati and Fan, 2005). At the same time, major productivity gains were achieved through sectoral shifts from agriculture to manufacturing and services. Particularly in East Asia, manufacturing played an important role, supported by trade reforms, skills-upgrading and infrastructure outlays.

As seen from the region's own experience, different reforms are needed at different stages of economic development. China is now promoting high-technology industries through road maps, such as "Made in China 2025", while gradually increasing the share of services in the overall economy. Yet for other developing countries in the region, expanding the manufacturing base, including to relatively labour-intensive sectors, will be important for broad-based productivity gains. India is planning to increase the share of the manufacturing sector in GDP to 25 per cent by 2020 through the creation of national manufacturing investment zones and measures to increase the ease of doing business. Similarly, Indonesia and the Philippines are seeking to diversify and upgrade their economies through infrastructure programmes and FDI liberalization measures. Many countries in the region could also enhance industry-service linkages, as the availability of cost-efficient services, such as distribution, business and logistics-related services, is crucial for improving overall productivity (ESCAP, 2016c).

The availability of a skilled labour force and the efficient allocation of capital will be important for such structural transformation. While levels of education have increased in most countries, the quality of education is a critical factor, as a shortage of skills would constrain the ability of economies to take advantage of technological change, thereby limiting productivity growth and economic diversification. At the same time, outdated or excessive labour market regulations could undermine the growth and dynamism of formal sector jobs. For instance, in India some 250 labour rules at the central and state levels and the process of enforcement, at least on paper, have been found to discourage investment (Sahoo, 2014). In Indonesia, a relatively high severance pay requirement is a key reason why firms tend to employ workers on a temporary basis (Allen, 2016). One reason why labour market regulations are relatively rigid in these countries is because of limited social assistance or social insurance programmes for unemployed workers. Thus, fiscal support for expansion of social protection could also facilitate necessary labour market reforms. In China, where the working elderly population is shrinking, restrictions on

the urban-rural household registration system (*hukou*) are being eased in order to increase labour mobility and enhance coverage of the population with social protection schemes.¹¹

For the efficient allocation of capital, parallel progress is needed in such areas as bankruptcy processes and banking sector reforms. China's legislature approved a modern bankruptcy law in 2007, but for years it has seldom been used. This situation has contributed to an accumulation of thousands of economically unviable enterprises that survive with the support of local governments and State-owned banks, and a rapid increase in non-financial corporate debt. In India, the recently approved insolvency and bankruptcy code is aimed at trimming 12 laws currently governing bankruptcy proceedings and shortening the resolution period to between 180 and 270 days.¹² In both China and India, excess capacity and leverage in certain sectors have impaired bank balance sheets. Beyond the implications for financial stability, banking sector reforms will be critical for the efficient allocation of resources and thus productivity growth. Banking supervision has been strengthened recently in China and India through more rigorous asset quality reviews, while such schemes as debt-equity swaps have been introduced to resolve corporate debt.

While structural reforms are generally viewed as productivity-enhancing, a careful assessment is needed on their distributional impacts. This is particularly important in the context of high or rising income inequality in many countries in the region. In general, reforms that tend to increase intersectoral productivity differentials can increase inequality, particularly in countries where the productivity gap across sectors is large and labour mobility is constrained (Fabrizio and others, 2017). Reforms that increase the relative price of tradable to non-tradable goods can also have significant distributional effects. This is because the poor tend to work in low productivity, non-tradable sectors. Reforms that reduce the costs of borrowing can increase inequality if financial access is limited. Most of all, labour market and social protection reforms would affect income distribution.¹³ The direction and degree to which this would happen depends in part on how the specific reform is designed and implemented, but complementary measures may also be required, particularly to ensure that poor and low-skilled workers are not left behind. As "creative destruction" of jobs takes place, workers will need to be equipped with correct skills and be protected from disruptive impacts (ESCAP, 2016d). Specific compensatory measures may also be required, not least to make reforms politically acceptable. For instance, when the Netherlands undertook labour market reforms in the 1980s and 1990s, cuts in unemployment,

illness and disability benefits were partly offset by cuts in workers' taxes and social security contributions.

The environmental impacts of structural reforms could also be considered, particularly given the increased environmental pressures in the region. For instance, to the extent that reforms discourage resource use or promote efficient resource use (by internalizing costs of eliminating subsidies, for instance) the environmental consequences can be positive. When the reforms promote resource use (by opening markets or reducing economic alternatives) the consequences can be negative (WWF, 2001).

Keeping in mind the broad objectives of productivity growth, equity and environmental sustainability, countries need to decide which reforms are most critical in the specific country context and whether several reforms could be bundled or sequenced. In the past, structural adjustment programmes in crisis-affected developing countries often took "one-size-fits-all" and "big bang" approach. An alternative approach is less ambitious, consisting of sequential targeting of binding constraints (Hausmann, Rodrik and Velasco, 2005). A potential advantage of this approach is that early wins could create political support for reforms over time, and that the sense of ownership will increase, which could also allow time for countries to "learn to reform". This situation is in contrast to the Washington Consensus¹⁴ and its augmented version, which tends to be prescribed from the outside and suffer from redundancy or the lack of a well-defined list of priorities. The region's own experience, including that of China, seems to support the sequential targeting approach. Moreover, the region's own experience also highlights the important role of the State in structural reforms. The Government provides an enabling environment of policies, institutions and public services that helps factor and product markets to work efficiently, which in turn enables private sector-led growth to take place.

4. ENHANCING THE QUALITY OF GROWTH

In addition to ensuring sustained and robust economic growth, policymakers will need to address some key social and environmental challenges in order to improve the quality of this growth. Relatively stable economic conditions provide an opportunity to make progress on both the productivity and inclusiveness fronts, particularly in the context of implementing the 2030 Agenda for Sustainable Development. This section contains a discussion on how the challenges of poverty and inequality could be

addressed through labour market and fiscal measures, including social protection. This argument is followed by a discussion on the environmental pressures in the region and policy options that could enhance resources efficiency.

4.1. Poverty and inequality call for labour market and fiscal measures

The benefits of economic expansion have accrued relatively less to the poor as is evident from rising income inequality. Available data indicate that some countries, including net commodity exporters, have witnessed a considerable decelerating trend in the rate of poverty reduction in the post-crisis period. Despite significant progress made by such countries as China in recent decades, the incidence of poverty remains in double digits in the majority of countries in the region, based on the threshold of \$3.10 a day, 2011 purchasing power parities (PPP) (see table 1.3). Sustained poverty reduction in the context of slower economic growth would need to rely more on enhancing the income distribution and addressing non-income factors, such as social exclusion. Income inequality, however, has increased or remains high in many countries, with a significant concentration of wealth at the top. Wide income inequality also undermines social cohesion and impairs long-term economic growth by reinforcing inequality of opportunities.

While "inclusive growth" is increasingly highlighted in national development agendas, its implementation could be challenging given that many of the drivers of inequality, such as technological progress, globalization and market-oriented reforms, are also essential features of prevailing economic frameworks (ESCAP, 2016d). Comprehensive measures are thus needed to tackle inequality, including labour market policies, such as minimum wages and training of low-skilled workers, and fiscal measures, such as progressive taxation and social assistance. Moreover, the need for such measures is likely to increase with further technological progress and structural changes in economies. For instance, the tax burden may need to be shifted away from labour income towards the owners of productive capital and wealthy individuals through capital income tax and wealth-related taxes (ESCAP, 2016d).

Productive and decent work is central to eliminating poverty and reducing inequality. Relatively slow employment growth and a persistently high share of vulnerable employment have contributed to rising income inequality. A prolonged output growth slowdown eventually translates into weak employment data. Economies can also experience instances when output grows at a steady pace, but employment growth remains

Table 1.3. Labour market and income distribution indicators (latest available year)

	Vulnerable employment (percentage of total employment)	Minimum wage (percentage of average earning)	Poverty headcount ratio (percentage of population)	Income inequality (Gini index)
East and North-East Asia				
China	13.7	32.6	11.1	42.2
Democratic People's Republic of Korea	..	..	..	..
Hong Kong, China	6.0	51.0	..	..
Japan	8.6	44.8	..	32.1
Macau	3.4	..	..	..
Mongolia	22.9	23.8	2.7	32.0
Republic of Korea	26.8	..	..	..
North and Central Asia				
Armenia	41.9	41.7	14.6	31.5
Azerbaijan	55.5	24.7	2.5	31.8
Georgia	55.9	2.4	25.3	40.1
Kazakhstan	25.6	17.2	0.3	26.3
Kyrgyzstan	37.2	5.5	17.5	26.8
Russian Federation	5.9	18.1	0.5	41.6
Tajikistan	47.1	36.0	56.7	30.8
Turkmenistan	..	..	..	..
Uzbekistan	..	..	87.8	..
Pacific				
Australia	10.9	44.4	..	34.9
Cook Islands	9.9	..	..	..
Fiji	39.0	..	18.5	42.8
Kiribati	53.3	..	34.7	37.6
Marshall Islands	..	..	..	..
Micronesia (Federated States of)	..	..	39.4	42.5
Nauru	..	..	..	..
New Zealand	12.2	..	..	..
Palau	..	..	..	..
Papua New Guinea	..	..	64.7	43.9
Samoa	30.9	..	8.4	42.7
Solomon Islands	..	..	69.3	..
Tonga	..	..	8.2	38.1
Tuvalu	..	..	16.3	41.1
Vanuatu	70.0	..	..	37.2
South and South-West Asia				
Afghanistan	..	..	..	..
Bangladesh	57.8	..	56.8	32.1
Bhutan	72.9	..	13.3	38.8
India	..	40.0	58.0	35.2
Iran, Islamic Republic of	40.3	..	0.7	37.4
Maldives	18.8	38.1	23.3	38.4
Nepal	..	..	48.4	32.8
Pakistan	63.1	82.5	36.9	30.7
Sri Lanka	40.8	46.4	14.6	39.2
Turkey	28.4	..	2.6	40.2
South-East Asia				
Brunei	..	..	..	..
Cambodia	55.2	..	21.6	30.8
Indonesia	31.0	69.5	36.4	39.5
Lao People's Democratic Republic	83.9	..	46.9	37.9
Malaysia	22.1	47.2	2.7	46.3
Myanmar	..	..	..	..
Philippines	37.6	126.9	37.6	43.0
Singapore	8.3	..	..	..
Thailand	51.4	63.6	0.9	37.9
Timor-Leste	70.4	..	80.0	31.6
Viet Nam	57.8	..	12.0	37.6

Source: ESCAP, based on data from International Labour Organization, ILOSTAT database of labour statistics. Available from www.ilo.org/global/statistics-and-databases/lang--en/index.htm (accessed 1 February 2017); Global Wage Report 2016/17 data sets. Available from www.ilo.org/global/research/global-reports/global-wage-report/2016/lang--en/index.htm (accessed 1 February 2017); and World Bank, World Development Indicators database. Available from <http://data.worldbank.org/> (accessed 1 February 2017).

Note: Minimum wage refers to statutory nominal gross monthly minimum wage effective 31 December. The poverty headcount ratio is based on the threshold of \$3.10 a day, 2011 PPP.

weak, which is particularly true when the skill bias of modern technology, which drives output growth, reduces the pace of absorption of unskilled labour.

In 2016, average employment growth in the Asia-Pacific region was modest but remained steady at 1.1 per cent, while the share of vulnerable employment remained persistently high at about 50 per cent (ILO, 2017a). Only a few countries made progress on both fronts of quantity and quality (the Philippines, for example) as others succeeded only on quantity (Indonesia) or quality (Thailand and Viet Nam) or failed on both (Sri Lanka). In China, the labour market continues to adjust to structural rebalancing in the economy. Resilience of the labour market in China, even as growth moderated in recent years, can be explained by expansion of the services sector and possible labour hoarding in overcapacity sectors. In India, demonetization has created short-term uncertainty in labour markets but could help address informality in the longer term. Across the region, some improvement was made in lowering unemployment, although youth still face disadvantages.

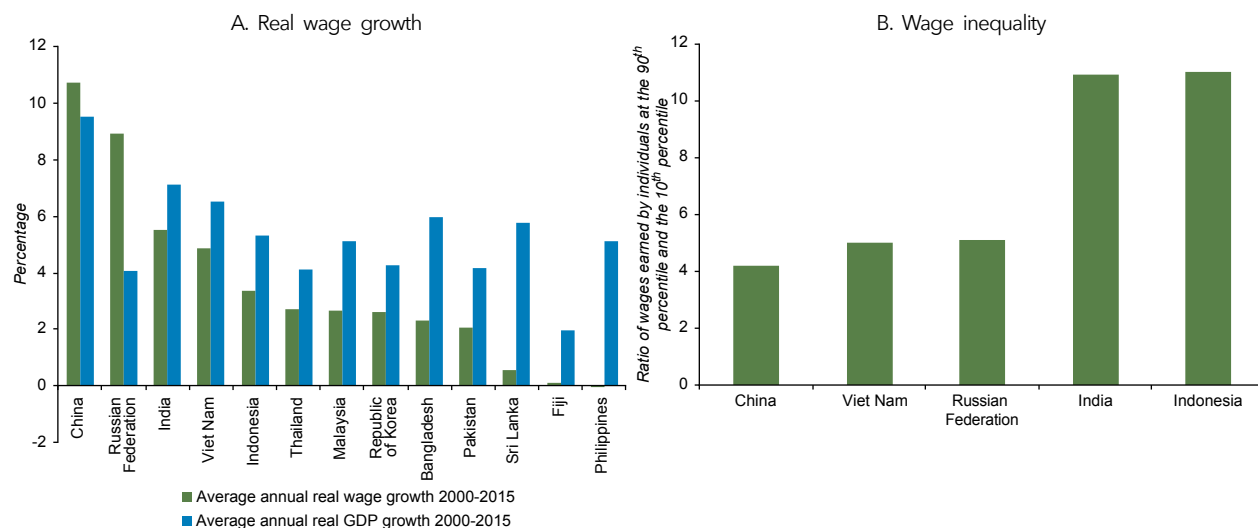
In 2015 (latest data), growth in real wages was relatively robust in South Asia (possibly due to disinflation) and China (where the share of labour in national income has been recovering). Wage growth in South-East Asia has also recovered in recent years in part due to minimum wage increases. Wage growth in the Asia-Pacific region, however uneven, outperforms that of the world as a whole. Between 2006 and 2015, real wages in the region grew

by 44 per cent, at a compound annual growth rate of 4.2 per cent. However, the region's dynamic performance is driven largely by China; wage growth elsewhere has been much more modest (see figure 1.19). Moreover, wage inequality varies considerably across countries. The top 10 per cent of wage earners earned about 10 times more than the bottom 10 per cent in Indonesia and Singapore. This ratio was also relatively high in India, Malaysia, the Philippines, Sri Lanka and Thailand.

Gender inequality in the labour market is evident not only in the low participation of women in wage employment (representing inequality of opportunity) but also in wages (inequality of outcome). Gender wage gaps are wide in South Asia, especially in Nepal and Pakistan. Although no national statistical data are available for China, one estimate suggested that the gender earning differential in China was about 23 per cent in 2009 (Meng, 2012).

While addressing such wage inequality, countries in the region will need to improve the overall link between productivity and wages. Effective collective bargaining can be one of the tools for rebalancing the gains from economic growth through facilitating fair wage increases in line with productivity. The payoffs from building stronger institutions have been demonstrated in some developed economies (such as Germany) where collective bargaining has facilitated economic restructuring – helping enterprises to cope with unexpected events and to strengthen training and skill formation.

Figure 1.19. Wage dynamics



Source: ESCAP based on data from International Labour Organization, ILOSTAT database of labour statistics. Available from www.ilo.org/global/statistics-and-databases/lang-en/index.htm (accessed 1 February 2017); and Global Wage Report 2016/17 data sets. Available from www.ilo.org/global/research/global-reports/global-wage-report/2016/lang-en/index.htm (accessed 1 February 2017)

Minimum wage policies are another important tool for setting fair wages in the region, by protecting workers who lack collective bargaining power, often low-skilled workers. Governments need to strengthen minimum wage-setting institutions and base decisions on sound evidence and communication with trade unions and employers. For instance, Malaysia and Viet Nam have both recently set up tripartite bodies to review minimum wages. In India, the Government announced a much-needed review of the minimum wage act of 1948. Another important concern is that, even though minimum wage systems may be in place, the rates are not adjusted regularly. For instance, in Thailand sizable adjustments in 2012/13 followed a long period of stagnation (ESCAP, 2013).

Labour migration and remittances are also important for poverty eradication, by supporting and smoothing consumption, especially for low-income households in rural areas. Remittance inflows are about 3 per cent of GDP in India, 7 per cent in Pakistan and 10 per cent in the Philippines. This ratio is much higher in landlocked developing countries, such as Kyrgyzstan, Nepal and Tajikistan, and small island developing States, such as Samoa. Remittances are often countercyclical, rising during economic downturns and natural disasters as migrants increase their transfer of funds in order to provide for their families' emergency needs. However, this was not necessarily the case in recent years as major oil-producing host countries suffered large terms-of-trade losses. Latest available data suggest that, while a recovery is under way in North and Central Asia in line with the rebound of the economy in the Russian Federation, this trend is not apparent in South Asian economies, which rely on remittances from the Gulf Cooperation Council region (see figure 1.20).

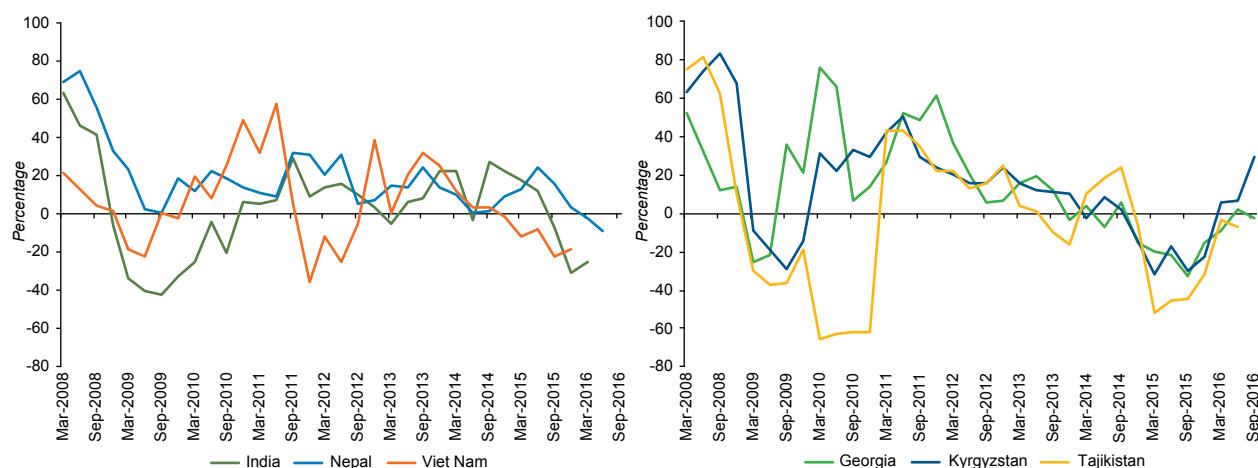
4.2. Social protection could reduce poverty and strengthen domestic demand

While many people have been lifted out of extreme poverty, the majority of the region's population are not yet "middle class" but could rather be classified as "transitional class" that are vulnerable to falling back into poverty (ESCAP, 2016c), which is why social protection is one of the selected topics in the quality of growth section. The importance of social protection in preventing people from falling into poverty and in reducing the duration of poverty, especially in times of rapid structural changes in the economy, has long been established (ILO, 2014). Countries with higher social protection spending tend to have a lower incidence of poverty (see figure 1.21).

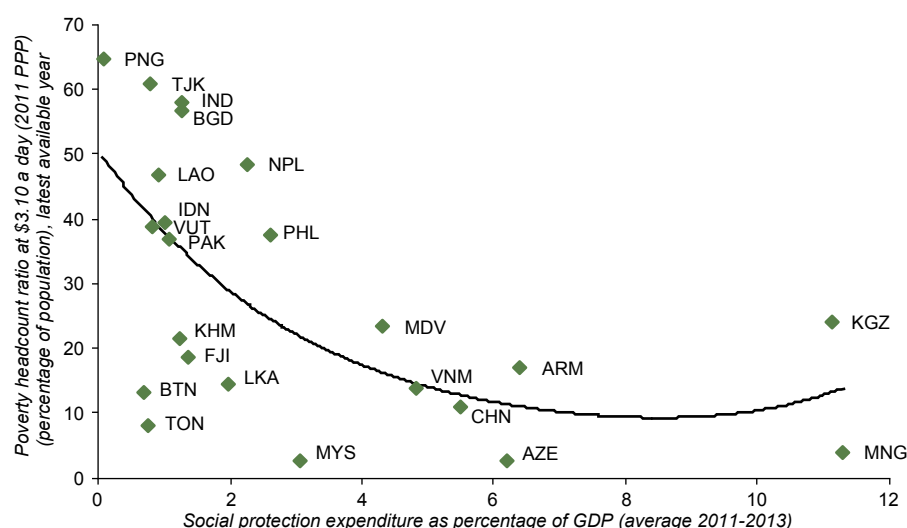
More recently, the developmental role of social protection has been recognized. By improving equity, opportunity and resilience, social protection provides a solid foundation for sustainable development (World Bank, 2012b; Devereux and Sabates-Wheeler, 2004). Aside from fulfilling people's rights, enhanced social protection can help strengthen domestic demand by reducing precautionary savings, so that the poor could consume more and also invest in higher-return livelihood strategies. Social protection could also improve the functioning of labour markets by facilitating skills development and employment, which are especially important in economies that are undergoing rapid structural changes. The role of social protection in reducing inequality has also been highlighted (ESCAP, 2015b).

Key aspects of a social protection floor¹⁵ include universal access to affordable health care; free primary and secondary education; unemployment benefits for wage

Figure 1.20. Remittances



Source: ESCAP, based on CIEC data.

Figure 1.21. Social protection spending and poverty incidence in developing Asia-Pacific economies

Source: ESCAP, based on Asian Development Bank, *The Social Protection Indicator: Assessing Results for Asia* (Manila, 2016), and World Bank, *World Development Indicators*. Available from: <http://data.worldbank.org/data-catalog/world-development-indicators>.

Abbreviations: ARM = Armenia; AZE = Azerbaijan; BGD = Bangladesh; BTN = Bhutan; CHN = China; FJI = Fiji; IDN = India; IND = Indonesia; KGZ = Kyrgyzstan; KHM = Cambodia; LAO = Lao People's Democratic Republic; LKA = Sri Lanka; MDV = Maldives; MNG = Mongolia; MYS = Malaysia; NPL = Nepal; PAK = Pakistan; PHL = Philippines; PNG = Papua New Guinea; TJK = Tajikistan; TON = Tonga; VNM = Viet Nam; and VUT = Vanuatu.

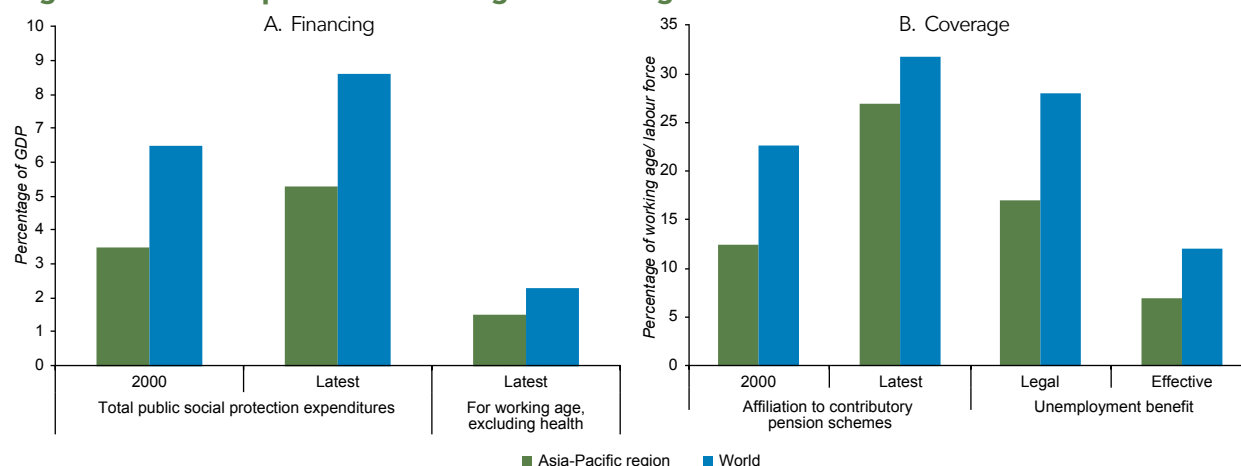
earners and income-support measures for those in need; contributory and social pensions; and full access to social benefits for persons with disabilities.

Social protection programmes for people of working age typically include social insurance, social assistance and labour market programmes. Social insurance is often financed through a contributory mechanism¹⁶ that involves beneficiaries, employers and the State, and covers such areas as health insurance, old-age pensions and unemployment, maternity, sickness and disability benefits. Social assistance is a non-contributory scheme, which takes the form of cash transfers (often conditional) to poor households, persons with disabilities and other vulnerable groups. It can be either universal or targeted.¹⁷ Active labour market programmes consist of skill development and training initiatives, special work schemes and wage and employment subsidies.

Based on the spending data that are available for the period 1996-2013 covering developing Asia-Pacific countries, 23 of 27 of them increased their investments for social protection as a share of total government expenditures. This reprioritization indicates that social protection is becoming more important for a large number of Governments in Asia and the Pacific (ESCAP, 2015b). Nevertheless, the Asia-Pacific region continues to fall behind the rest of the world in terms of social protection financing and coverage (see figure 1.22). Total public social protection spending, including health

expenditures, as a percentage of GDP increased from 3.5 per cent in 2000 to 5.3 per cent in 2010/11 (latest year) in the region, but this was still lower than the global average of 8.6 per cent. Of the total, non-health social protection expenditures for people of working age in the region stood at 1.5 per cent compared with 2.3 per cent for the world (ILO, 2014). Social insurance continues to dominate social protection spending in the region. Almost three quarters of GDP per capita spent on social protection per capita is allocated to social insurance. Social assistance accounts for only 0.9 per cent of GDP per capita, while active labour market programmes account for only 0.1 per cent of GDP per capita (ADB, 2016).

In terms of social protection coverage, countries such as China, Thailand and Viet Nam have made notable progress since the 2000s, but coverage levels remain weak in most countries in the region. For a median country in the region, about a third of the total population was covered by at least one type of social protection scheme. For a median country, social insurance coverage was about 14 per cent and social assistance coverage was about 24 per cent.¹⁸ Affiliation with contributory pension schemes was estimated to have increased from 12.5 per cent of the working-age population in early 2000 to 27 per cent in the 2010s, converging towards the global average of 31.8 per cent (ILO, 2015). Some 17 per cent of the labour force was legally covered by an unemployment benefit (contributory or non-contributory)

Figure 1.22. Social protection financing and coverage

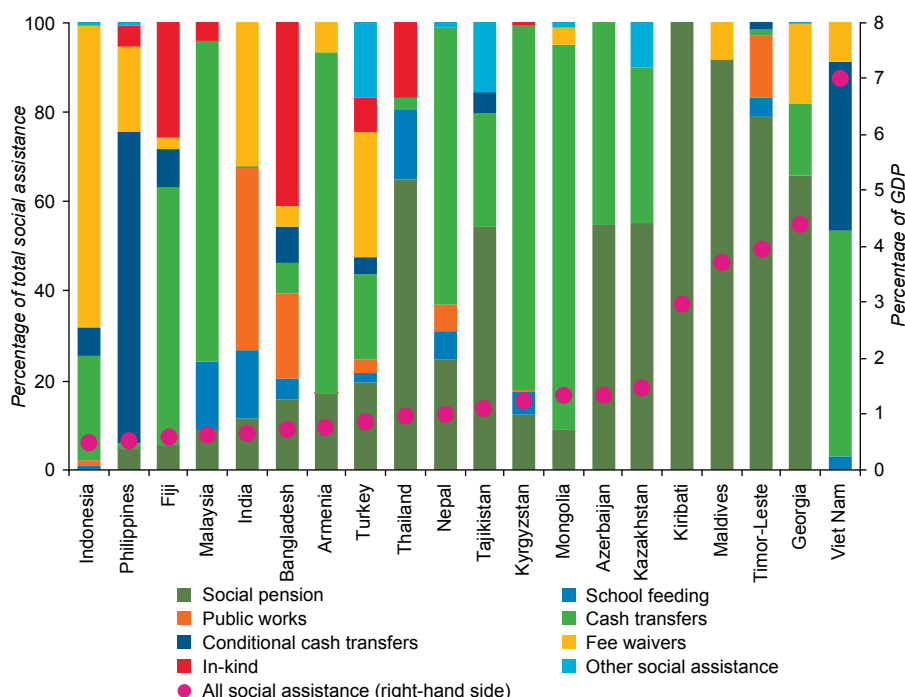
Source: ESCAP, based on International Labour Organization, Social Protection Platform. Available from www.social-protection.org/gimi/gess/ShowTheme.action?id=10 (accessed 1 February 2017).

Note: Figure in panel B shows contributory pension schemes coverage as percentage of working age; and unemployment benefits coverage as per cent of labour force.

in the region compared with the global average of 28 per cent. The effective coverage, however, was only 7 per cent in the region and 12 per cent in the world.¹⁹

As noted above, social assistance spending – which is particularly important for the poor and vulnerable – is relatively low in the region, accounting for less than 1 per cent of GDP in most countries. Apart from the need to scale up financing for this purpose, it is interesting

that countries in the region prioritize different forms of social assistance depending on their policy priorities, history, and population and workforce composition (see figure 1.23). Social pensions are prominent in transition economies, which tend to have higher social assistance spending than other economies. Public works is quite prominent in South Asian economies with large populations, including Bangladesh and India. Conditional cash transfers are prominent in the Philippines and

Figure 1.23. Social assistance spending, by components

Source: ESCAP, based on World Bank, Atlas of Social Protection: Indicators of Resilience and Equity (ASPIRE) database (accessed on 1 February 2017).

Viet Nam. Fee waivers, such as for health-care services, are highly utilized in Indonesia,²⁰ India and Turkey, and school feeding programmes in Malaysia and India.

Also as noted above, active labour market programmes are not widely used in the region. Given that the Asian and Pacific region is expected to witness more "creative destruction" of jobs as economies undergo further structural changes and market reforms, social protection measures could be growth-enhancing if supported by labour market programmes, training and mobility schemes. Public employment services, including training and job-matching assistance, could strengthen employability, especially for young people in navigating the school-to-work transition. In addition, enhanced career counselling, motivational training and job readiness preparation are essential to empower youth to make informed decisions about prospective employment opportunities. Greater investment in employment offices and agencies in order to raise their profile and capacity could potentially align the job search methods used by young people with the hiring methods of employers.

Low public social protection spending in the Asia-Pacific region is partly the result of a long-prevailing development model that extends absolute priority to economic growth at the expense of redistributive policies (ILO, 2015). This is also reflected in overall low levels of government expenditures. However, the Asian financial crisis of 1997/98 and the global economic and financial crisis that began in 2008 exposed the limitations of this development model. There has indeed been a gradual shift in policy thinking, and a number of countries are now actively trying to enhance national social protection systems.

A number of countries have introduced inclusive health-care or insurance schemes which cover informal workers. Thailand, for instance, took a radical step in 2001 towards achieving full population coverage in health care by introducing a universal health care system, now popularly called the "UC scheme" (earlier known as the "30 baht scheme"). It offers all Thai citizens access to health services provided by designated district-based networks of providers, consisting of health centres, district hospitals and cooperating provincial hospitals.²¹ Individuals are able to access a comprehensive range of health services, in principle without co-payments or user fees, including both inpatient and outpatient services and maternity care furnished by public and private providers within a framework which emphasizes preventive and rehabilitative aspects.

In the Lao People's Democratic Republic, informal sector workers can join the National Social Security Fund on a voluntary basis under the 2014 Social Security Law.

Coverage includes access to a number of social security benefits, including health care and maternity benefits, based on a contribution rate of 9 per cent of their chosen reference wage. In Mongolia, universal maternity protection coverage is accessible through a combination of different mechanisms. While formal sector employees are covered by social insurance on a mandatory basis and receive a replacement rate of 100 per cent of their covered wage for four months, informal workers can join the scheme on a voluntary basis and receive maternity cash benefits for four months at a replacement rate of 70 per cent of their selected reference wage after 12 months of contributions.

In 2004, China initiated the Sunshine Project on Training for Rural Labourers Seeking Jobs in Urban Areas in the interest of enhancing the employability of rural workers, better managing migration and protecting basic social rights. The project entitles working-age members in rural households to receive vocational skills training. In 2007, the Sunshine Project successfully provided training for 11.25 million farmers; the training had a positive impact on both employment rates and earnings compared with those who did not attend the training programmes (ILO, 2011). More recently, social protection was extended to rural migrant labourers working in urban areas. In the initial phase, migrant workers were covered by a scheme separate from urban residents. Since the implementation of the Social Security Law in 2011, migrant workers are allowed to be registered by their employers under the same scheme for urban residents; coverage has reached about 26 per cent of about 270 million migrant workers.

In South Asia, where informal employment is particularly prevalent, public works have been quite prominent. In India, the Maharashtra Employment Guarantee Scheme supported the creation of roads and infrastructure, including irrigation structures, to overcome the main challenges posed by arid and dry land. This scheme led to the creation of seasonal occupation and improved access to land for the poor. In the expanded National Rural Employment Guarantee Programme, emphasis is laid on activities that enhance agricultural productivity and generate long-term dynamic income and employment gains.

In view of the fact that social protection coverage in Asia and the Pacific is still relatively low and that there are important gaps in both the depth and breadth of social assistance for the working-age population, a series of policies needs to be considered.

The development of social protection floors is a multi-step process that includes a national social dialogue, financing strategy and delivery mechanisms. As with

public goods in general, social protection is a matter of political choice, which requires sufficient national dialogue. This is especially the case for developing national “floors” and universal schemes, which a growing number of countries are considering. Comprehensive social protection legislation needs to be developed. Coordination across government ministries and between national and subnational levels would be important to ensure coherent delivery of entitlements and avoid fragmentation, exclusion and overlaps.

Successful country experiences show that universal schemes can be affordable. As fiscal space might not be sufficient, Governments should explore innovative ways of financing social protection. Options to finance social protection schemes include: budget reallocation, such as phasing out general subsidies and containing wage bills; expenditure efficiency, for example reducing leakage through such schemes as direct benefit transfer; pension and health system reforms, such as increasing incentives for people to use community-based health services; and revenue enhancements, such as tax policy and administrative reforms and earmarking of financial resources.

Coverage could be expanded progressively, as has been done in China for the rural population and then for the uninsured part of the urban population. Expanding coverage to include the large informal sector remains a challenge, although some countries, such as China and Thailand, have been able to successfully establish universal health care and pension schemes through a combination of contributory and non-contributory approaches. There have also been innovative approaches to expand coverage, such as employment injury insurance in Bangladesh and Malaysia and the rural employment guarantee in India. Synergies should be sought, for instance by strengthening public health infrastructure through public employment programmes. Labour market programmes, although less widely used in the region, could enhance the economic growth impact of social protection.

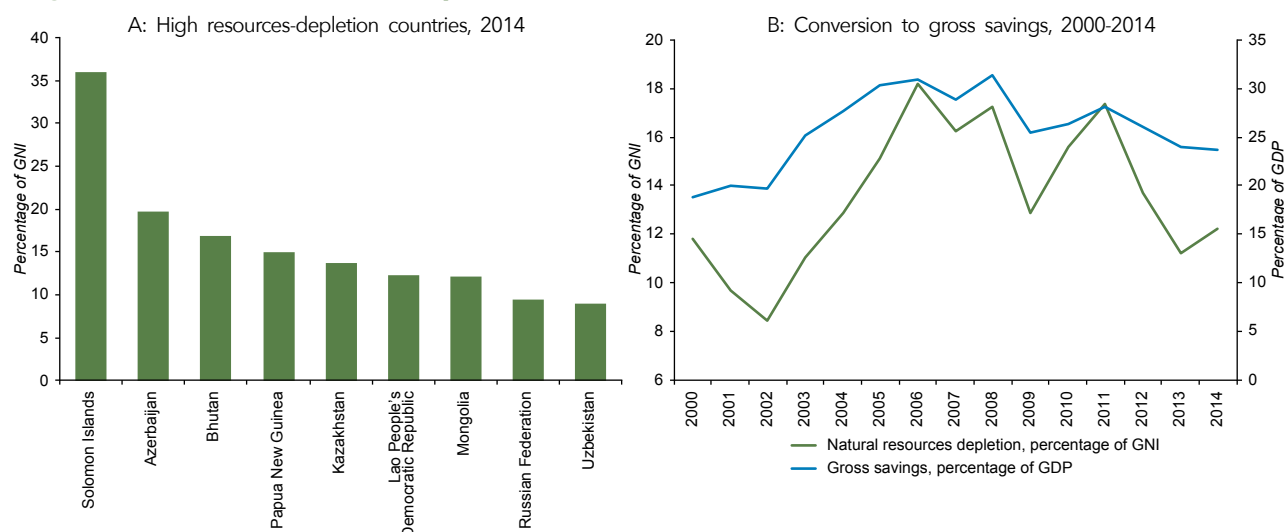
4.3. Environmental degradation is too costly to overlook

Over the past few decades, the Asia-Pacific region has experienced phenomenal real economic growth averaging 7 per cent over the period from 2000 to 2015, but this has been achieved in part at the cost of environmental degradation, concomitant health impacts and the intensive and unsustainable use of countries’ natural resource wealth.²² The region is highly vulnerable to climate change, the adverse effects of which can substantially undermine

the economic development gains in the region and could force more than 100 million people in the region into extreme poverty by 2030.²³ Inefficient and unplanned urban expansion has resulted in the conversion and loss of forests, wetlands and other ecosystems and has increased the already high exposure to disasters, with poor and disadvantaged communities being the most severely affected.²⁴ Clean air, safe drinking water, sufficient food and secure shelter – key determinants of health – are adversely affected, with projected direct damage costs to health estimated to reach between \$2 billion and \$4 billion per year globally by 2030.²⁵ Globally, air pollution is considered to be the major factor in having caused more than half of the 7 million premature deaths recorded in 2012.²⁶ Contaminated drinking water affects about one third of the population in South and South-East Asia,²⁷ while small island States face problems of limited drinking water as a result of sea-level rise. About 80-90 per cent of urban wastewater from developing countries in the region²⁸ is discharged directly – without treatment – into surface water bodies.

These effects expose the limits of GDP as a measure of economic performance and social progress. If citizens are concerned about the quality of air, and air pollution is increasing, then statistical measures that do not account for air pollution will provide an inaccurate estimate of what is happening in terms of their well-being. Therefore, it is important to examine measures that can go beyond GDP to capture a country’s natural capital and changes both in its natural wealth over time and in environmental degradation. Indeed, what is measured affects decision-making, so if measurements are flawed, decisions may also be distorted. This was the underlying premise of the Commission on the Measurement of Economic Performance and Social Progress (CMEPSP), which was created in 2008 with prominent economists as members who are concerned about the adequacy of current measures of economic performance, in particular the limits of GDP as a measure of societal well-being.²⁹ CMEPSP concluded, among other things, that sustainability assessments require a well-identified “dashboard” of indicators based on the concept of “stocks”. The United Nations Statistical Commission has elaborated international statistical standards for national accounts data to incorporate the dimension, which is captured by its System of Environmental-Economic Accounting.³⁰

Figure 1.24 shows natural resource depletion – the sum of net forest depletion, energy depletion and mineral depletion of a country for a given year – and reflects the decline in asset values associated with the extraction and harvest of natural resources, analogous to the depreciation of fixed assets.³¹ Natural resource depletion is significant

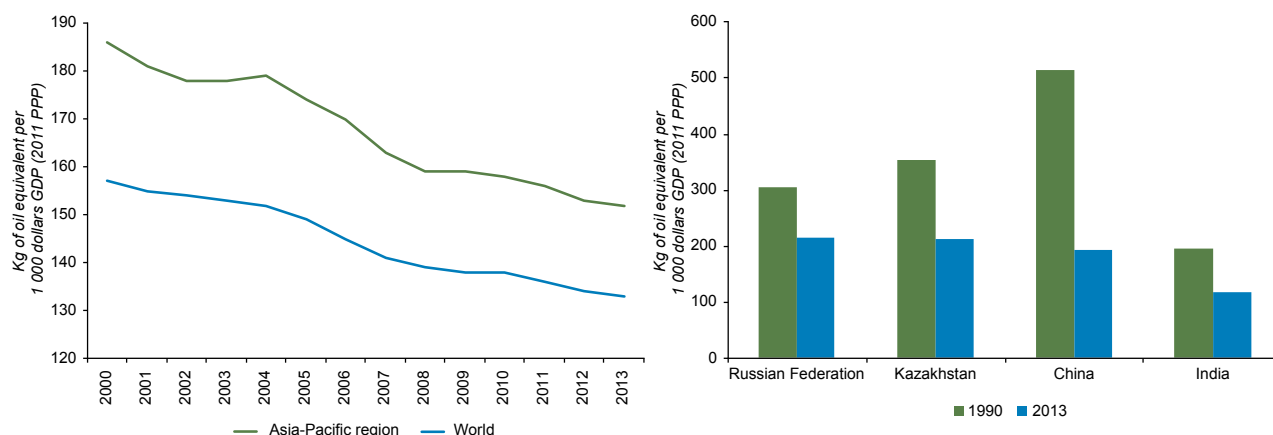
Figure 1.24. Natural resources depletion

Source: ESCAP, based on data from World Bank, World Development Indicators.

Note: Panel B shows the median value of countries in panel A, excluding Bhutan, Papua New Guinea, Solomon Islands and Uzbekistan, for which full time series data are not available.

across countries in the region, reaching as high as 36 per cent of gross national income (GNI) in Solomon Islands, showing the extent to which economic growth has been achieved through significant disinvestment in a country's natural assets. While it is conceivable that some countries converted their assets into other types of savings, such as through sovereign wealth funds or the recycling of resource income by State-owned companies back into domestic investments, over time the rates of resource depletion observed are not sustainable and raise the issue of intergenerational equity. Moreover, although gross savings trends seem to be generally correlated with the depletion of resources (see figure 1.24), this may not be the case in some countries.

The region's growing weight in the global economy and its rapidly expanding manufacturing base have predictably resulted in increasing shares of global energy, material and water consumption, as well as greenhouse gas (GHG) emissions. Energy intensity – the ratio of total primary energy supply (TPES) to GDP – remains high, especially among the large oil producers and in China, although it is being steadily reduced over time (see figure 1.25). Total energy intensity for the region was 152 kg of oil equivalent per \$1,000 GDP (2011 PPP) in 2013, which is a decline of almost 20 per cent since 2000, but still above the global average. Fossil fuels – coal, oil and natural gas – continue to dominate total primary energy supply and its growth. Coal usage almost tripled,

Figure 1.25. Energy intensity

Source: ESCAP, based on the data from International Energy Agency. GDP figures are sourced from World Development Indicators.

from 1,067 million tons of oil equivalent (Mtoe) in 1990 to 2,939 Mtoe in 2014, while the share of coal as a primary fuel grew from 32 to 43 per cent, compared with a more modest rise in the global average, from 25 to 29 per cent.

The region already accounts for roughly half of global GHG emissions, and the high-growth path on which many of the region's economies find themselves means that this contribution will grow unless there are fundamental policy interventions. Emissions intensity in the region has been decreasing faster relative to that of the world, but in 2012 was still about 1.4 times higher than global emissions intensity (see figure 1.26). The region's GHG emissions per capita increased from 4.4 metric tons in 2000 to 6.3 metric tons of carbon dioxide equivalent in 2012, no longer far from the global per capita average of 7.5 metric tons of carbon dioxide equivalent.

In terms of domestic material consumption, the Asia-Pacific region consumed about 53 per cent of the world's materials in 2010. The region needed 2.6 kg of materials to produce \$1.00 of GDP, which means it still lags behind the rest of the world where on average only 1.3 kg was needed (see figure 1.27). The regional average, however, masks wide ranges, from 17 kg per dollar in Mongolia to 0.3 kg per dollar in Japan, with the poorest countries that are also the most dependent on natural resources often exhibiting very low resource efficiency. While material use reflects the production of goods and services, the material footprint is based on consumption patterns.^{32,33} Even in industrialized countries, material footprints continue to rise at about 1 per cent per year, showing that there is no level of income yet at which material consumption levels off.³⁴ Nevertheless, the region still had roughly double the global average footprint in 2010. The region's water use accounts for more

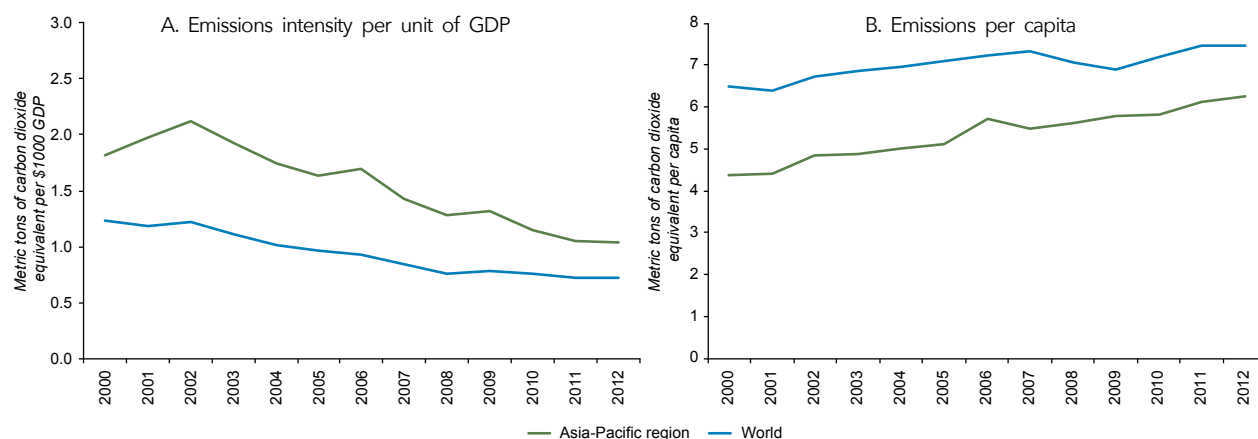
than half of global water use. The relative sectoral shares of water consumption were 80 per cent for agriculture and 10 per cent each for industry and municipal use.³⁵ Although water use is decreasing – due to improvements in the agricultural sector and irrigation – water intensity in the region's developing countries is still very high and, for the region as a whole, exceeds the global average by a factor of two.

Countries in the region are stepping up to the challenge of increasing energy- and resource-efficiency and tackling environmental degradation. Policy instruments can broadly be categorized as (a) regulatory; (b) market-based; and (c) voluntary or information-based. In practice, a mix of these policy instruments is employed to better achieve higher energy- and resource efficiency and improve environmental outcomes.

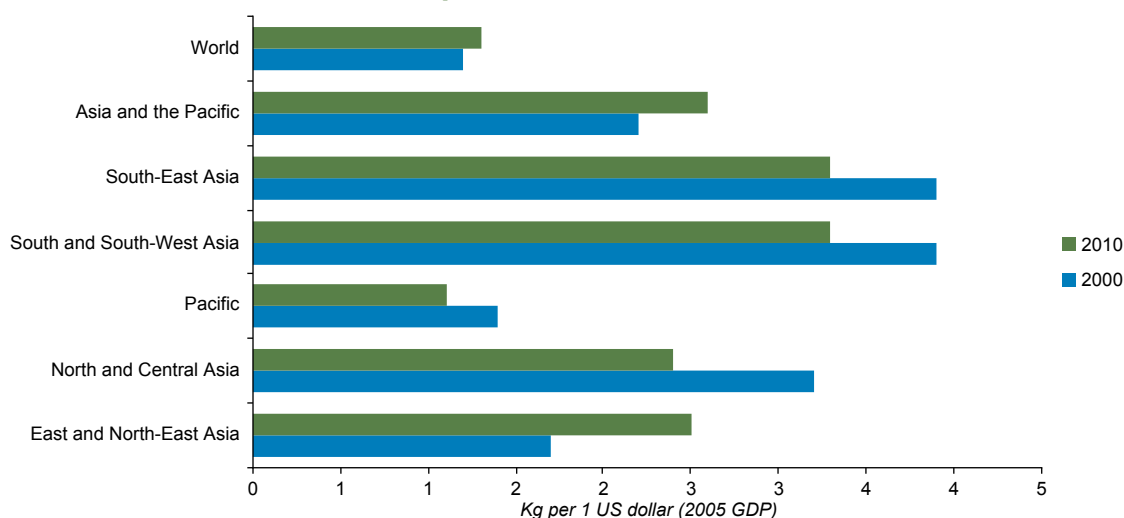
First, regulation is typically used to control hazardous point sources of pollution in air, water and land. Its advantage lies in exerting direct control over the environmental outcome it is seeking to address, which makes it ideal as an instrument to limit hazardous substances so that they do not exceed a specific amount set by scientific authorities for health considerations. Any pollution exceeding the ceiling levels would subject the polluter to fines. This type of instrument is information-intensive in that the regulator must regularly measure or spot-check the actual emission point sources at each installation. It is also inefficient relative to market instruments because – provided the emissions are below the established ceiling – it does not provide the polluter with any incentive to reduce emissions further, nor does it direct pollution abatement activities towards the lowest-cost polluter.

Examples from the region include Japan's Air Pollution Control Act, which stipulates allowable limits for

Figure 1.26. Carbon emissions, 2000-2012



Source: ESCAP statistical database. Available from http://data.unescap.org/escap_stat.

Figure 1.27. Domestic material consumption

Source: ESCAP statistical database. Available from http://data.unescap.org/escap_stat.

automobile exhaust gas.³⁶ The Republic of Korea's Green Procurement Policy, adopted in 2005, legally requires all public sectors to use sustainable products. As a result, between 2004 and 2010, the scale of green production has increased by a factor of four. Viet Nam's Law on Energy Efficiency and Conservation is aimed at achieving a 10 per cent reduction in energy intensity in energy-intensive industries and in codes for energy-efficient buildings.

Second, economic instruments rely on prices or markets to function and encompass taxes, subsidies and emissions trading systems (ETS). The advantage of market instruments concerns their superior allocative efficiency, the positive incentives that they provide and their revenue-generating ability. Emissions abatement falls first on those polluters that handle it in the most cost-efficient manner, which provides incentives to reduce pollution and emissions and to invest in environmentally friendly technologies. Market instruments are less information-intensive in that they require only regulators to set the price (in the case of a tax) or the quantity (in the case of an ETS) of the relevant instrument, but this also gives them less control over the actual environmental outcome.

Examples from the region include the emissions trading systems for GHG emissions in China, Japan and the Republic of Korea, and the energy efficiency trading programme for major Indian industries known as the "Perform, Achieve and Trade" programme. Singapore plans to introduce a carbon tax from 2019, which will initially value a ton of carbon at between S\$ 10 and S\$ 20, which is approximately the level of carbon internal shadow pricing being adopted by a number of progressive private sector companies.³⁷ Experience suggests that these

instruments need to be phased in slowly, with the tax rate increasing over time. Energy subsidies – especially on petroleum products and electricity – are prevalent in Asia, which accounted for about one third of global energy subsidies in 2013. In many countries in the region, fossil fuel subsidies account for a large share of GDP; for example, based on estimates for 2014, they accounted for about 20 per cent of GDP in the Islamic Republic of Iran, followed by the Russian Federation and India (both at about 10 per cent), Indonesia (7 per cent) and China (4 per cent). In the wake of the global oil price decline in 2014, a number of countries, including Indonesia, have aggressively phased out fuel subsidies.³⁸

Third, voluntary and information-based measures include toxic release inventories or pollutant release and transfer registers, or "ecolabels", consumer awareness-raising campaigns and corporate sustainability reporting. One of the advantages of information instruments is the relatively low implementation cost compared with the complex administration needed to implement regulatory or market-based approaches. The limited costs involved in the use of such tools means they can be more easily employed by least developed economies. However, voluntary measures often have limited (sectoral) coverage and are sometime considered less effective than other measures.

Examples from the region include Thailand's carbon reduction label, which uses a lifecycle approach to give a measure of a product's contribution to GHG emissions, thus providing consumers with information that can help direct them towards less environmentally harmful purchases. Viet Nam has introduced mandatory labelling

for certain market segments. The Singapore Packaging Agreement 2007 between the Government and the food and drink industry has led to the development of industry action plans and sets targets to reduce packaging waste from various packaging materials.

Priority policy actions for the region to achieve more sustainable growth include the following:

1. Pursue further energy subsidy reform and promote carbon pricing, that is, get the price right: Energy subsidies distort resource allocation decisions by encouraging wasteful fossil fuel consumption and reducing incentives for investment in renewable energy. In contrast, carbon pricing, either through carbon taxes or ETS, puts a price on the negative externality generated by carbon-generating production activities. Such pricing encourages a shift in consumption to goods or services with lower carbon content, either for consumption or as input into the production process. Further, it provides a market signal that helps spur innovation in low-carbon products and processes (see also the section on East and North-East Asia in chapter 2).

2. Enhance energy and water efficiency opportunities across various sectors: As buildings account for about a third of global total final energy consumption, and building stock is rapidly expanding in the region to accommodate population growth, economic growth and urbanization trends, there is huge potential for making energy efficiency improvements in the residential sector, especially in building design, heating and cooling, lighting and household appliances. In addition, the Asia-Pacific region is the world's manufacturing hub and therefore offers enormous potential for electricity savings from the institution of measures to improve industrial energy efficiency. Better water pricing policies that discriminate between high- and low-value users and that encourage lower use of water are needed to achieve water saving.

3. Put decoupling of resource use and economic growth at the centre of development planning and improve capacities for sustainable consumption and production: Innovative approaches to reducing, reusing and recycling wastes from cradle-to-grave and value-chain perspectives are vital to ensure sustainable consumption and production (SCP) patterns in line with Sustainable Development Goal 12. Institutional capacity-building at the national and local levels, financial support, especially for less developed countries, and technology and knowledge transfer and appropriate human resources development in support of SCP are essential. High-level political support is necessary for successful SCP policy implementation, including from their piloting and demonstration to the point of their implementation and enforcement, especially based on existing SCP initiatives in the region.³⁹

5. CONCLUDING REMARKS

In 2016, economic conditions in the region began to stabilize, with a better-than-expected performance exhibited by China and with a recovery under way among net commodity exporters. In line with the region's growing purchasing power, domestic private consumption has been the major growth driver. Private investment has been less forthcoming amid weak global demand and heightened uncertainty. On the external front, trade and capital flows have been volatile. Structural changes and rising protectionist measures in trade suggest that exports are unlikely to be a major driver of growth despite the recent mild recovery. Given the depreciation of regional currencies, any boost to exports may be offset by increased pressure on corporate balance sheets with high dollar debt. Economic growth is expected to be slightly more broad-based in 2017 and generally stable at about 5 per cent. However, global policy uncertainty and trade protectionism are major downside risks. Bouts of financial volatility are also likely, with tighter global financial conditions. Within the region, China's role as originator and transmitter of shocks has increased. In the medium term, strengthening domestic and regional demand will be critical against a tough external environment.

Monetary policy space has narrowed in the past year, with policy stances recently shifting from "accommodative" to "neutral" amid upside risks to inflation. Monetary policy efficacy also seems to have declined, as reflected in a weaker-than-expected boost to domestic demand. Domestic financial stability concerns also need to be addressed. Thus, for the purpose of supporting economic growth, countries will inevitably need to rely more on fiscal measures. Given the region's large development spending needs, however, existing fiscal space should be used effectively. Some countries may also need to enhance revenue mobilization, on which fiscal sustainability and debt trajectory also ultimately depend. Countries should consider potential positive spillovers of social and infrastructure investments on the economy. Fiscal measures could be complemented by structural reforms to lift productivity, including labour market reforms and financial sector reforms that improve the allocation of resources. However, the distributional impacts of such reforms should be assessed and addressed, as well as their potential environmental impacts.

The benefits of economic expansion have accrued relatively less to the poor as is evident from rising income inequality in the region. Comprehensive measures are needed, including labour market policies, such as minimum wages, and fiscal measures, such as progressive taxation and social assistance. Despite the

notable progress made in a number of countries, the region as a whole falls behind the rest of the world in terms of social protection financing and coverage. Financing options include budget reallocation, expenditure efficiency, pension and health system reforms, and revenue enhancements. Coverage could be expanded progressively through a mix of contributory and non-contributory schemes, keeping in mind the large informal sector. At the same time, environmental degradation and the intensive and unsustainable use of natural resources need to be addressed. To lower the region's energy and carbon intensity of growth, countries could deploy a mix of regulatory, market-based and voluntary or information-based measures. Priority policy actions include energy subsidy reform and carbon pricing; capturing energy and water efficiency opportunities across various sectors; and improving capacities for sustainable consumption and production.

ENDNOTES

- ¹ General Assembly resolution 70/1.
- ² See chapter 2 for further discussion of such country-level developments. Chapter 1 is focused more on regional economic performance and drivers of growth.
- ³ While data on underemployment are relatively scarce, it is likely that labour market conditions were relatively stable despite the export slowdown due to firms retaining their workers on the expectation of a rebound.
- ⁴ Using the pre-crisis period as a benchmark is for illustrative purposes only and has nothing to do with the "optimum" level or growth of private investment.
- ⁵ While trade restrictive measures have steadily increased in the wake of the global economic and financial crisis, protectionist sentiments may have increased while the resolve to resist protectionism may have weakened recently. For instance, the communique of the Group of Twenty Finance Ministers and Central Banks Governors Meeting on 17-18 March 2017 dropped the language from last year that vowed to "resist all forms of protectionism". Available from www.g20.utoronto.ca/2017/170318-finance-en.html.
- ⁶ For instance, it is possible that regional currencies could actually appreciate, at least temporarily (a) in the wake of a United States fiscal stimulus announcement if the size of the stimulus is smaller than the market expects, and (b) similarly, in the aftermath of a United States federal funds rate increase if the pace of increase is slower than expected.
- ⁷ The basic equation for debt sustainability may be recalled:

$$d_t - d_{t-1} = pd_t - \frac{g_t - r_t}{1 + g_t} d_t$$

where d_t refers to the debt to GDP ratio in period t ; pd_t the primary deficit; g_t the nominal GDP growth rate; and r_t the nominal effective rate of interest (borrowing cost) on government debt. This equation shows that if a Government is running a primary deficit, nominal growth must exceed the nominal interest rate to keep debt from increasing.
- ⁸ Primary fiscal balance is defined as general government net borrowing or net lending, excluding interest payments on consolidated government liabilities.
- ⁹ While structural reforms are generally associated with productivity growth, there is no precise agreed definition. The potential scope could be thus quite broad. For instance, the 2004 Leaders' Agenda to Implement Structural Reform of the Asia-Pacific Economic Cooperation consisted of five priority areas: competition policy; regulatory reform; strengthening economic and legal infrastructure; corporate governance; and public sector governance. A 2015 IMF policy paper on structural reforms identified the following 11 areas: agriculture; trade liberalization; legal system and property rights; capital market development; banking system; infrastructure; fiscal structural reforms; labour market; business regulations; industry regulations; and technology and innovation. According to a 2016 paper, the World Bank's current emphasis on structural reforms includes: promoting good governance and public sector reforms; increasing domestic resources mobilization; supporting inclusive growth, gender, social protection, environmentally sustainable growth; and enhancing competition for productivity and job growth.
- ¹⁰ While productivity gains can arise from the adoption of advanced countries' technologies or better use of resources within sectors of the economy, they often also reflect structural change – reallocation of resources from less productive sectors (such as agriculture) into higher-productivity ones (such as industry and services) or new activities.
- ¹¹ About 30 provinces announced guidelines on *hukou* reforms in April 2016. However, while steps are being taken to remove the distinction between rural and urban household registration in smaller towns and cities, these reforms will not apply in the largest municipalities owing to concerns about how improved access to public services for former rural *hukou* holders will be financed.
- ¹² In China, only 20,000 bankruptcy cases in total were accepted by courts between 2008 and 2015. IMF estimates that for each insolvency case accepted by China's courts, another 100-250 enterprises are estimated to have gone out of business, mostly through deregistration and business license cancellation. In India, despite the creation of new institutions and bankruptcy tribunals, as well as the use of digital records and electronic filing, the benefits of the new law will likely take years to flow through the Indian economy, as there is a backlog of 70,000 bankruptcy cases.
- ¹³ In the context of OECD countries, see, for instance, Causa, Hermansen and Ruiz (2016). Empirical studies on developing countries are relatively scant.
- ¹⁴ A set of economic policy prescriptions for developing countries, and Latin America in particular, that became popular during the 1980s.
- ¹⁵ In 2009, the United Nations System Chief Executives Board for Coordination launched the Social Protection Floor Initiative in response to the global financial and economic crisis. In 2012, the adoption by consensus of the Social Protection Floors Recommendation, No. 202, by 185 ILO Member States gave impetus to its implementation and reflected a global commitment to the cause of extending social protection to all.
- ¹⁶ Contributory schemes are those in which contributions made by protected persons directly determine entitlements to benefits. They can be wholly financed through contributions usually paid by both employers and workers, but often are partly financed from taxation or other sources.

- ¹⁷ Examples of targeted social assistance programmes include the unconditional poverty-targeted cash transfer programme in China and the poverty-targeted conditional cash transfer programme in the Philippines, while an example of a universal social assistance programme is the Universal Health Care programme in Thailand.
- ¹⁸ Based on World Bank, Atlas of Social Protection: Indicators of Resilience and Equity (ASPIRE) database.
- ¹⁹ Based on ILO Social Protection Department, ILO LABORSTA database.
- ²⁰ For example, Indonesia prioritized the local-level implementation of Jamkesmas (Jaminan Kesehatan Masyarakat, or social health insurance), the national free health-care programme for the poor. Implemented from 2008 to 2013, the programme provided about 76 million low-income Indonesians with free basic health-care services and has enabled a dramatic expansion in access to health care among the poor.
- ²¹ Thailand offers migrants the opportunity also to be a part of the scheme by purchasing insurance for the equivalent of \$58 per year.
- ²² For details, see UNEP, *Global Environment Outlook (GEO-6): Regional Assessment for Asia and the Pacific (Nairobi, 2016)*. Available from http://web.unep.org/geo/sites/unep.org/geo/files/documents/geo-6_ap_final_en_complete.pdf.
- ²³ For further information, see World Bank, *Shock Waves: Managing the Impacts of Climate Change on Poverty* (Washington, D.C., 2015). Newest estimates for the Asia-Pacific region show that climate change will cause significant impacts on growth. Without action on climate, GDP in the region could decrease by as much as 3.3 per cent by 2050 and 10 per cent by 2100, relative to the base case. See Asian Development Bank, *Asian Development Outlook 2016 Update: Meeting the Low-Carbon Growth Challenge* (Manila, 2016).
- ²⁴ Estimates are from ESCAP, UN-Habitat and Rockefeller Foundation, "Pro-poor urban climate resilience in Asia and the Pacific: quick guide for policy makers". Available from www.unescap.org/resources/quick-guide-policy-makers-pro-poor-urban-climate-resilience-asia-and-pacific-0.
- ²⁵ WHO has estimated that, between 2030 and 2050, climate change is expected to cause approximately 250,000 additional deaths per year due to malnutrition, malaria, diarrhoea and heat stress. Available from www.who.int/mediacentre/factsheets/fs266/en/.
- ²⁶ The results are from J. Lelieveld and others, "The contribution of outdoor air pollution sources to premature mortality on a global scale", *Nature* 525, pp. 367-371. Available from www.nature.com/nature/journal/v525/n7569/pdf/nature15371.pdf.
- ²⁷ For additional details, see R. Bain and others, "Global assessment of exposure to faecal contamination through drinking water based on a systematic review", *Tropical Medicine and International Health*, vol. 19, No. 8, pp. 917-927. Available from www.ncbi.nlm.nih.gov/pmc/articles/PMC4255778/.
- ²⁸ See ESCAP and UN-Habitat, *The State of Asian and Pacific Cities Report 2015: Urban Transformations - shifting from quantity to quality*. Available from www.unescap.org/sites/default/files/The%20State%20of%20Asian%20and%20Pacific%20Cities%202015.pdf.
- ²⁹ For further information, see https://en.wikipedia.org/wiki/Commission_on_the_Measurement_of_Economic_Performance_and_Social_Progress.
- ³⁰ For details, see <http://unstats.un.org/unsd/envaccounting/seea.asp>.
- ³¹ Adjusted net savings, including natural resources depletion, is an indicator calculated by the World Bank. The adjustments for capital depletion are not comprehensive in that they do not include some important sources of environmental degradation, such as underground water depletion, unsustainable fisheries and soil degradation. This results from the lack of internationally comparable data rather than from intended omissions. Net forest depletion is a unit resource rent times the excess of roundwood harvest over natural growth. Energy depletion is the ratio of the value of the stock of energy resources to the remaining reserve lifetime (capped at 25 years). It covers coal, crude oil and natural gas. Mineral depletion is the ratio of the value of the stock of mineral resources to the remaining reserve lifetime (capped at 25 years). It covers tin, gold, lead, zinc, iron, copper, nickel, silver, bauxite and phosphate.
- ³² Material footprint is the attribution of global material extraction to domestic final demand (consumption and capital investment) of a country. It is calculated as the raw material equivalent of imports plus domestic extraction minus the raw material equivalents of exports. See indicators for a resource efficient and green Asia and the Pacific 2015. Available from www.unep.org/asiapacificindicators.
- ³³ For additional details, see <http://unstats.un.org/sdgs/files/metadata-compilation/Metadata-Goal-12.pdf>.
- ³⁴ Indicators for a resource efficient and green Asia and the Pacific are available from www.unep.org/asiapacificindicators.
- ³⁵ For further information, see ESCAP and others (2016).
- ³⁶ See Japan, Ministry of Environment (www.env.go.jp).
- ³⁷ For example, in 2016 Mahindra and Mahindra became the first Indian company to implement an internal carbon fee of about \$10 per ton in order to help achieve its goal of reducing greenhouse gas emissions by 25 per cent over the next three years.
- ³⁸ Experience shows that six elements are common to successful reform efforts, namely improving delivery of social support through subsidy targeting and cash transfers; institutional reforms to facilitate market-level pricing of energy; appropriate phasing-in and sequencing of price increases, differentiating across energy products; facilitating improvements in energy efficiency; comprehensive energy sector reform with clear objectives together with a good understanding of its impacts and broad stakeholder consultation; and a transparent communications strategy.
- ³⁹ Specific SCP initiatives in the region include the Asia Pacific Roundtable on Sustainable Consumption and Production and the European Commission funded the SWITCH-Asia Programme. At the country level, these include the National Action Plan for Sustainable Consumption and Production in the Philippines and Viet Nam, and national round tables in China, India and Viet Nam. The 10-year framework of programmes on sustainable consumption and production patterns (10YFP) has also propelled thematic programmes centred on sustainable buildings and sustainable tourism, sustainable lifestyles etc., for which there are regional components in the Asia-Pacific region. The concept of SCP is increasingly embedded in national strategies for sustainable development. For example, China has operationalized "circular economy" principles and pollution control into national pollution frameworks, while its "eco-civilization" strengthens this approach by integrating environmental protection into societal and environmental goals. Thailand set SCP as one of four national strategies of its Tenth National Economic and Social Development Plan.